



# ACCOUNTING



Produced by the Ministry of Education, Suva, Fiji

First Produced February, 2015

Copyright - Ministry of Education

This book has been prepared by the Curriculum Development Unit at the Ministry of Education, Suva, Fiji for use by Accounting students at Year 11. It may contain copyright materials copied under the provisions of the Fiji Copyright Act 1999. This material cannot be sold or copied for further distribution without the Ministry's permission.

# PREFACE

This first edition of Year 11 Accounting text has been written in line with the Year 11 Accounting Syllabi. It has been written to provide Year 11 Accounting students with a detailed knowledge on how to manage their personal finances effectively for their financial well-being. Latest information and updates are given on personal income tax. Considerable attention has also been given to the basic Accounting concepts that all students should understand. The text will assist them in designing an effective accounting system which are processed, analyzed and reported ethically and objectively.

The book contains six strands. Each strand opens with a strand outcome followed by a list of learning outcomes. The content is written in a concise and direct manner which will enable the students to prepare well for the exams. As new concepts and terms are introduced, they are defined and explained and reference made to specific local examples. Teachers should, where possible, extend students' knowledge by referring to current examples. Throughout the text, explanations are given in simple language to ensure understanding and to encourage students to discover basic concepts through their own study activities.

The text will assist the students to choose an appropriate accounting profession as detailed information is provided on the careers in accounting.

Formulas, examples with solutions are used throughout the book to enhance students learning of the accounting procedures and concepts.

Optimistically, this text would make the learning and teaching of accounting more enjoyable, interesting and challenging.

# ACKNOWLEDGEMENT

The Year 11 Accounting textbook, has been produced by the Curriculum Development Unit of the Ministry of Education.

The following people are acknowledged for their contribution in the development of this Accounting textbook.

Mrs. Sunita Devi Deo	SEO Accounting (CDU)
Mrs. Sikiti Sukanavere	SEO Economics (CDU)
Mr. Pranesh Kumar	DAV Girls College
Mr. Sukul Deo	Dudley High School
Mr. Bishwar Narayan Maharaj	Suva Grammar School
Mrs. Malni Prasad	John Wesley College
Mr. Mosese Vuibeqa	Cathedral Secondary School

# TABLE OF CONTENT

<b>Preface</b>	
<b>Acknowledgements</b>	
<b>STRAND 1: PERSONAL FINANCE</b>	
1.1 Personal Money Management	6
1.2 Personal Income tax	18
<b>STRAND 2 : NATURE OF ACCOUNTING</b>	
2.1 Accounting Theory	30
2.2 Careers in Accounting	40
<b>STRAND 3 : FINANCIAL ACCOUNTING AND THE ACCOUNTING PROCESS- I</b>	
3.1 Business Ownership	45
3.2 Accounting Equation	60
3.3 Analysis Chart	67
3.4 Ledger and Trial Balance	70
<b>STRAND 4 : MEASURING PERIODIC INCOME - I</b>	
4.1 Balance Day Adjustments	83
4.2 Worksheet and Final Accounts	103
<b>STRAND 5 : ANALYSIS AND INTERPRETATION OF FINANCIAL STATEMENTS - I</b>	
5.1 Analyzing Accounting Reports - Vertical	125
<b>STRAND 6 : SYSTEMS FOR IMPLEMENTING THE ACCOUNTING PROCESS - I</b>	
6.1 Accounting System and Internal Control	138
6.2 Sub -System - Cash	143
6.3 Sub - System - Inventory	161
6.4 Sub - System - Fixed Assets	180



# PERSONAL FINANCE



## Strand Outcome

Describe and apply principles and processes to personal finances, taxation, banking and personal record keeping taking into account the cultural diversity in Fiji.

## Learning Outcomes

- Explore the process of developing and amending a personal budget to reflect changing circumstances
- Investigate the forms of savings by different cultural groups in Fiji.
- Explore and evaluate on how Income Tax affects Personal Income in Fiji.

STRAND

1

## 1.1 PERSONAL MONEY MANAGEMENT

### Personal budget

- ✚ A Personal budget is a plan of income and expenditure for a given period of time.
- ✚ Budgets can be used by the households, businesses and individual people.

#### ➡ Why do people need a Budget?

- ✚ It makes it possible for them to reach their goals.
- ✚ It can help to save for a short term, middle term and long term item.
- ✚ Helps to make it easy to save and have more extra money.
- ✚ A budget allows you to easily track and control your spending and reduce stress.

#### ➡ Why do we save?

- ✚ It allows you to set your priorities for household items and your needs.
- ✚ It helps to keep out of debt and stop falling behind in repayments.
- ✚ Restrain from impulse buying.
- ✚ Get as many wants as possible.



#### ➡ Types of Budget

- ✚ There are three types of Budget:
  - Surplus Budget
    - Is where the income is more than the expenses.
  - Deficit Budget
    - Is where the expenses are more than the income.
  - Balanced Budget
    - Is where expenses are equal to income.

**Variance** – is the difference between the budgeted amount and the actual amount spend for a period of time.

#### ➡ Components of a Budget

- ✚ A budget is made up of income and expenses.
- ✚ Income
  - This is the revenue or earning that are derived from an individual, or a family.
  - It can be in the form of wages, salaries, profit, interest earned on fixed term deposit, etc.
- ✚ Expenses
  - Expenses are fixed and variable.

- **Fixed expenses** remain the same throughout the accounting period.
- **Variable expenses** tend to fluctuate or change over time.

### Conversion of Amount

Amount in:	Week	Fortnight	Month	Year
<b>Week</b>	*1	*52/26	*52/12	*52
<b>Fortnight</b>	*26/52	*1	*26/12	*26
<b>Month</b>	*12/52	*12/26	*1	*12
<b>Year</b>	/52	/26	/12	/1

### Format of a Budget

Budget of \_\_\_\_\_ for the \_\_\_\_\_

<b><u>Incomes</u></b>	<b><u>\$</u></b>	<b><u>\$</u></b>	<b><u>\$</u></b>
Wages/Salary	XX		
Sale of Farm Produce	XX		
Pocket Money	XX		
Interest on Fixed term Deposit	XX		
Pocket Money	<u>XX</u>	<u>XX</u>	
Total Incomes			XXX
<b><u>Less Expenditure</u></b>			
<b><i>Variable Expenses</i></b>			
Food	XX		
Clothing	XX		
Medical	XX		
Entertainment	XX		
Travelling	<u>XX</u>	XX	
<b><i>Fixed Expenses</i></b>			
Rent	XX		
Hire Purchase	XX		
School Fees	XX		
Insurance	<u>XX</u>	<u>XX</u>	
Total Expenses			<u>XXX</u>
<b>Savings / Deficit</b>			<b><u>\$XXX</u></b>

### ***Illustrative Example***

Ganesh works as a lab technician in CWM Hospital earning \$1000 net per month. His wife is a data analyst in the same business earning \$195 weekly. They receive rent of \$200 monthly from one of their flat



Their expenses were as follows:

Weekly Shopping – Groceries	150
Insurance monthly	50
Car payment monthly	200
Fuel Expense Monthly	150
Sky plus subscription yearly	600
Hire purchase monthly	30
Telephone monthly	50
Clothing fortnightly	150
Medical Yearly	300

**Required:**

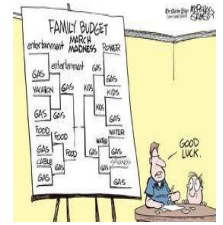
Prepare a Monthly budget for Mr. and Mrs. Ganesh.

**Solution:**

**Budget for Mr. and Mrs. Ganesh for the month of June, 2014**

<b>Income</b>	\$	\$	\$
Ganesh's Salary		1000	
Mrs. Ganesh's wages		845	
Rental Income		<u>200</u>	
<b>Total Income</b>			<b>2045</b>
<b>Less Expenses</b>			
<b>Variable Expenses</b>			
Shopping – Grocery	650		
Fuel Exp	150		
Telephone	50		
Clothing	325		
Medical	<u>25</u>	<u>1200</u>	
<b>Fixed Expenses</b>			
Insurance	50		
Car Payment	200		
Sky Pacific Subs	50		
Hire Purchase	30	<u>330</u>	
<b>Total Expenses</b>			<b><u>1530</u></b>
Savings			<b><u>515</u></b>

### Activity 1.1.1



#### A. Multiple Choice

1. Budgeting is
  - A. not necessary for most people.
  - B. recording how you have been spending your money.
  - C. plan of how you organize your income and spend wisely.
  - D. getting the most savings.
2. You should always do your budget
  - A. weekly.
  - B. monthly.
  - C. either, monthly or weekly.
  - D. in a time period that matches your income.
3. Sharon has income of \$2000 per month. After all her expenses she has \$150 per month left. The \$150 per month is her
  - A. gross income
  - B. savings
  - C. net income
  - D. net Expenses
4. Which of the following can be classified as a fixed expense?
  - A. buying daily lunch
  - B. pocket expenses
  - C. rent payment
  - D. clothing

## B. Matching

Match the items in Column 1 with the statement in Column 2

1. Budgeting		A. A plan of income and expenditure for the year
2. Budget		B. Unspent income during the year
3. Variable expenses		C. Shows income equals expenditure
4. Fixed expenses		D. Expenses remain the same through the period
5. Balanced budget		E. Act of preparing the budget
6. Savings		F. Costs that change from to time

## Problem Solving

1. Serene has an income of \$400 per month. After paying for all the expenses she is left with \$50. Calculate the amount of expenses she incurred.
2. Ropate has a take home pay of \$1500 per week. His total spending per week is \$1200. He is intending to buy a Sofa Set worth \$3000. How long will it take for him to save in order to buy the Sofa set?
3. List four reasons why you need to save money as a student.
- 4.

Item	Budget	Actual	Variance
Food	\$150	150	
Clothing	55	64	
Entertainment	35	80	
Medical expense	80	72	
Fuel expense	18	16	

### **Required:**

- a) Complete the table by calculating the variance column.
- b) Which item from the table requires necessary control?
- c) Which expense is uncontrollable? Give your reason.

5. P. Kumar, works as an accountant for KPMG in Suva. His salary per month is \$2000. His wife is a school teacher and her salary is \$450 per fortnight. The family incurs the following expenses:

Rent	\$200 per month
Food and Gas	\$500 per fortnight
Sky Pacific subs	\$45 per month
Rates for city	\$550 per year
Car Fuel	\$50 per week.
Phone and power	\$150 per week
Medical	\$80 per month
Clothing	\$200 per fortnight

**Required:** Prepare a fully classified budget for P.Kumar's family for a period of one year. Classify the Income and expenses.

6. Given below is April budget for Joan's family.

<b>Income</b>	<b>\$</b>
Joan's salary	1800
Rent	500
<b>Less expenses:</b>	
Food & clothing	250
Travelling	50
Power bill	80
Mortgage payment	150
Medical	50
Hire purchase	140
Credit card payment	200
Insurance	95

**Required:** Use the information in Joan's budget and answer the questions given below.

- Classify the above expenses into fixed and variable expenses.
- Calculate the amount of fixed expenses. What percent of the budget comprise of the fixed expense.
- Calculate the amount of variable expenses.
- Calculate the amount of saving for the month of April. State two advantages of preparing a family budget.

7. Kisan works for Suva Garage as a mechanic. He earns \$300 per fortnight. He has \$20000 in fixed deposit for 5 years for which he gets 5% interest p. a. Kisan plans to spend his earnings on his family in the following way:

**Expenses for one year:**

Food	32%
Clothing	8%
Travelling	12%
Medical	10%
Electricity	8%
Rent	6%
Insurance	5%
Entertainment	6%

**Required:**

- What was his total income for the year?
- Calculate the amount spend in \$ on fixed expense during the year.
- Calculate the amount of savings in \$ for one year.

## FACTORS AFFECTING TAKE HOME PAY

### ➡ Gross Pay

✚ **Gross Pay** is the total amount paid to an employee each pay period. Gross pay includes regular pay, overtime pay, and other taxable earnings (such as reimbursements).

### Calculating Gross Pay

#### ➡ Hourly Gross Pay

✚ Hourly gross pay is calculated by multiplying the number of hours worked in the pay period times the hourly pay rate. Overtime pay is also included in the gross pay calculation.

#### ➡ Salaried Gross Pay

✚ Gross pay for salaried employees is calculated by dividing the total annual pay for that employee by the number of pay periods in a year. For example, if a salaried employee's annual pay is \$32,500, and he or she is paid twice a month, the gross pay for each of the 26 pay periods is \$1250.

### Types of Deduction

➡ Employers make deductions from employees' wages either on a statutory or voluntary basis.

✚ A **voluntary deduction** is one that the employee volunteers or agrees to be deducted from his or her pay. E.g. Insurance, Union deductions.

✚ A **statutory deduction** is one that is compulsory by state or law. Statutory deductions take various forms. Eg. PAYE tax

**Take Home Pay** – is the net pay or wages received by an employee after all the deductions are done.

### ➡ Factors affecting Take Home-Pay

✚ The amount of money earned that is the gross pay.



- + Deductions may be compulsory such as income tax or optional such as union fees, FNPF contributions, automatic savings deductions, repayment of loans etc.



### Activity 1.1.2

#### Short Answers

1. Define Gross Pay.
2. State what is meant by Take Home Pay/ Net Pay.
3. Differentiate between Voluntary deductions and statutory deductions.
4. Find a person who earns gross salary. Using the table list the deductions made by him/her.

Eg : FNPF Contribution		

Find out the nature of each deduction.

### GOALS AND PRIORITIES

- + All goals need to be SMART.
  - **S**pecific – provides further detail about the goal.
  - **M**easurable – how will you know when you have achieved the goal?
  - **A**chievable – can this be realistically achieved?
  - **R**elevant – is this related to your dreams?
  - **T**ime – there is a date set for the achievement of the goal.
- + Setting goals and priorities is an essential activity before drawing up any budget.
- + Some of the goals include:
  - Paying off debts
  - Saving for
    - a car
    - a stereo
    - a new cell phone
    - tertiary study
    - an overseas trip, etc.



### Activity 1.1.3

#### Goal Priorities:

1. List some of the things you would like to achieve.
2. For each of the goals listed above re-do them so that they are SMART. Categorise them as short, medium and long term.
  - i. Short Term

Specific	_____
Measurable	_____
Achievable	_____
Relevant	_____
Time Bound	_____

- ii. Put them in order of importance to you.

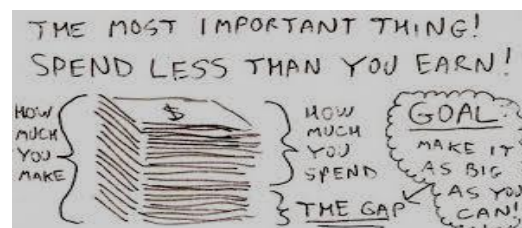
### BUGDET MODIFICATION

#### Steps in developing and monitoring a budget :

1. Set goal/ priorities.
2. Gather information on net income received.
3. Get the list of monthly and annual payments such as car registration etc.
4. Set a weekly savings amount.
5. Calculate income on weekly basis.
6. Calculate all payments on weekly basis.
7. Total all income.
8. Separate payments into needs and wants
9. Identify them as fixed and variables.
10. Total all payments. Calculate Surplus /deficit.
11. If in deficit make alterations.
12. Monitor the budget.

✚ Circumstances in life often changes. Our budget needs to change to reflect this. Examples:

- An unexpected pregnancy
- Being made reluctant
- Joining FNPf
- A planned pregnancy so we want to save in preparation for the new baby
- Move from part-time employment [or vice versa]
- Want to retire at age 50
- Want to work overseas in 2 years



- Want to own your home by the time you are 28



#### Activity 1.1.4

1. Divya and Dayal live in Nakasi. They are working and have two children. The month of January is about to end and the family is not in the position to cater for its rent payment to the landlord. Divya's son is quite sickly and they cannot cut down on their medical expenses.

The following budget relates to Divya and Dayal's family.

#### Monthly Budget:

<b>Income</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
Dayal's salary		700	
Divya's wages		200	
			<u>900</u>
<b>Less expenses:</b>			
<b>Fixed Expenses</b>			
Rent	150		
Hire purchase	140		
Car repayment	200		
Insurance	95	585	
<b>Variable Expenses:</b>			
Food & clothing	150		
Children's pocket expense	50		
Electricity	80		
Clothings	200		
Medical	70	550	
			<u>1135</u>
<b>Total Deficit</b>			<b><u>235</u></b>





- i. Divya and Dayal ended up with a deficit budget of \$235. Suggest ways in which they can readjust their budget in order to cater for the necessary expenses.
- ii). List some the necessary expenses that the family need to meet.
- iii). Will there is any impact of the readjustment of budget on her two children. Explain.
- iv) Divya and Dayal did not manage their risks well. List two risks taken by the family which ended up with a deficit situation.
- v) Depending on the amounts readjusted prepare a new budget for Divya's family for a month which will indicate balance the budget.

2. Villiame is planning to buy a car which costs \$11000. He wishes to find out whether he is really able to meet the monthly payment of \$250. His bank account balance of \$4000 is sufficient to meet the deposit requirement. Villiame works as an accounts clerk and his pay is \$150 a week.

His expenses are as follows

Groceries and marketing	\$50/ month
Traveling	\$18/ week
Medical	\$15/month
Electricity	\$40/month
Entertainment	\$30/month
Rent	\$100/ month
Insurance	\$150/year

### ***Additional Information***

-  Villiame's salary increased by 5% per week.
-  Traveling expense decreased to \$15 a week
-  Medical Expenses increased by \$10 per month
-  Villame has done some gardening so his groceries and marketing expense has reduced by 4%.

### **Required: Considering the above adjustments:**

- i. Calculate Villiame's total income for the month.
- ii. Calculate Villiame's variable and fixed expense for the month.
- iii. Work out the savings or deficit for the month.
- iv. Will Villiame be able to meet his monthly hire purchase payment? Give a reason.
- v. How long will it take him to complete payment for the car if he continues to meet his monthly payment?

## Saving Systems of Different Cultural Groups in Fiji

1. I Taukei Culture– Savings is done together as a team. Family members and relatives save money for the cultural activities and other needs.

Strength: there is team work and savings is done as a group.

Major challenge is that Younger generations are diverting from this savings plan due to modernization.

2. Indian Culture: Mostly saving is done on individual basis, that is save for own family's needs and priorities. The strength is that many individuals are strong savers and can save in large amounts.

3. Chinese Culture – Similar to Indian. Saving is done on individual basis. Family members save for only nuclear family's priorities.



### Activity 1.1.4

#### Short Answers and Research

1. Define Savings.
2. List some of the tips of saving money.
3. Explain the importance of saving money.
4. Identity some of the challenges faced by individuals who plan to save.
5. **Research Work:** Students to investigate on how savings is done in their own cultural context and present the information to the class.
6. Identify the strengths and weaknesses of the way saving are done in different cultures. ( Group Work)



## 1.2 PERSONAL INCOME TAXES



### WHAT IS PERSONAL INCOME TAX

It is the tax charged directly by the tax authority on the total income of employees. According to the Income Tax Act All employees in Fiji with an income above \$16000 are entitled to pay **PAYE as a compulsory deduction** to the tax authority.

#### ➡ **PAYE As Final Withholding Tax**

- ✚ PAYE is a Final Withholding Tax with effect from 1<sup>st</sup> January 2013. Allowances that were previously enjoyed by individuals such as Marital, Child, Elderly Dependent and FNPF/Insurance have been withdrawn. Employers are required to deduct the **correct tax**. With PAYE being a final tax means the majority of employees will not be required to lodge income tax return (Form S) from 2014.

#### ✚ **Who should lodge a return?**

- Employees:
- Those who have two or more employments during the year and the total employment income received is above \$16,000.00.
- Those who have other sources of income such as business, dividend income.
- Those that receive a demand notice from the Commissioner to lodge a return.

#### ➡ **1. Employee Obligation**

- ✚ Employees must complete and provide an employee tax code declaration form to their employer containing the following:
  - Employee Tax Identification Number (TIN).
  - Employee name & address.
  - Indicate Tax Code:
  - **“P” - primary employment,**
  - **“S” - secondary employment**

#### ➡ **Primary Employment**

- ✚ Means the main employment for the employee.  
An employer will deduct tax at an applicable rate.

#### ➡ **Secondary Employment**

- ✚ Means any employment other than primary employment.  
An employer will deduct tax at highest tax rate of 20%.

#### ➡ **TIN Registration**

- ✚ **How can Individuals obtain a TIN?**

- Individuals that do not have a TIN must apply to FRCA, by completing a TIN application form.

### **Tax Identification Number (TIN)**

- ✚ The Tax Identification Number (TIN) is a unique identifier issued by FRCA to identify all categories of tax and duty payers. The use of a Tax Identification Number (TIN) helps to handle queries, trace correspondences and store information for each person that is registered for customs and tax purposes.

FRCA also issues FNPf/FRCA Joint ID cards. To obtain one, the applicant must complete: Joint Card Registration Form.

- ✚ Requirements to obtain Joint ID:
  - Complete the **Joint Card Registration Form**
  - Original or certified copy of full extract post 2000 Birth Certificate
  - Original or certified copy of Marriage Certificate if you are using or wish to use your married name.
  - For those who do not have Fijian birth certificates must present their passport
  - FNPf Member ID or any other form of **valid** photo Identification such as the Electronic Voter Registration (EVR) card, Driving License, Passport, etc. if you DO NOT have a FNPf Member ID card.
  - In the absence of a photo ID, members of the public may submit a passport sized photo **certified** by a Justice of Peace, Provincial Administrator, Commissioner for Oaths or by FNPf/FRCA Customer Service Counter Officers.

### ➡ **What to do with the completed form?**

- ✚ If all the requirements are available, one should bring the application to any FRCA (Customer Service Centre) office to obtain the new joint FNPf/FRCAID card. TIN/new joint FNPf/FRCA ID card may be issued immediately. Once the TIN/ new joint FNPf/FRCA ID card is received one should quote the TIN in all correspondences and communications with FRCA.

### ➡ **Application of PAYE**

- ✚ PAYE will apply to the gross amount of the following:
  - Salary & wages.
  - Gratuities.
  - Cash allowances.
  - Commission or other amounts for services.
  - The estimated annual value of non-cash benefits if not covered under Fringe Benefits Tax.
  - Directors' or management fees, etc.

## ➡ Double Taxation

- Situation where a country levies tax on an income that has already been taxed in the same or another country.

### ✚ Relief from Double Taxation

Double taxation of Fiji residents is avoided by allowing credits for foreign tax paid on income derived from countries with which Fiji has tax treaties. Fiji allows unilateral relief from double tax on income from non-treaty countries, provided the income has been subject to tax in that other country. Fiji has entered into Double Tax Agreement (DTA) for the avoidance of double tax with the following countries:

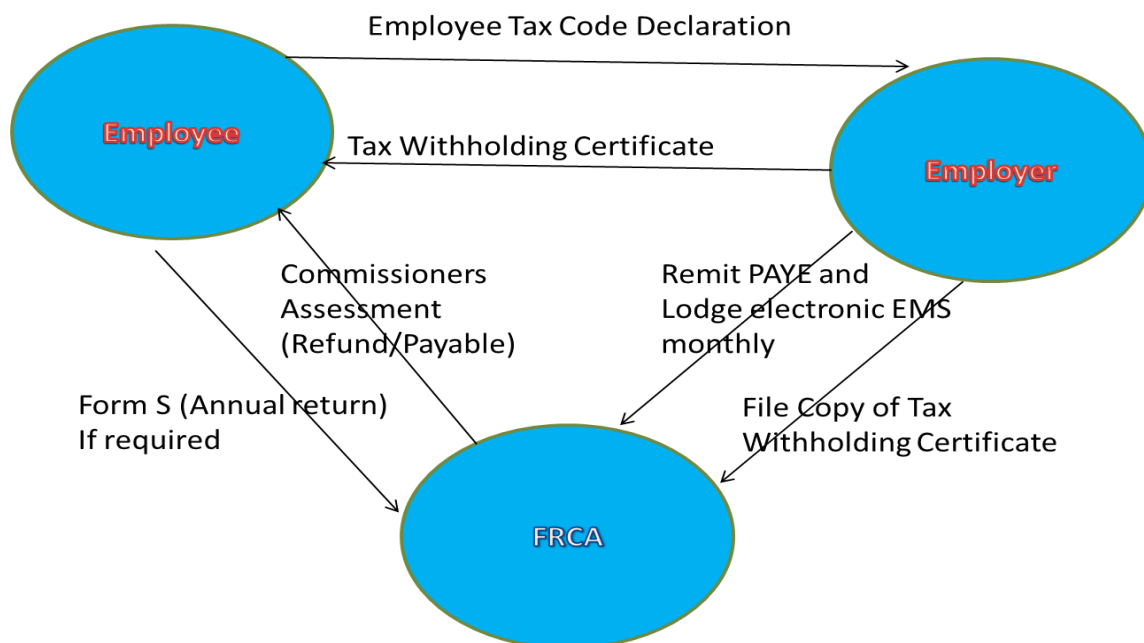
- United Kingdom
- New Zealand
- Japan
- Australia
- Korea
- Malaysia
- Papua New Guinea
- Singapore
- United Arab Emirates
- India
- Qatar



## ➡ 2. Employer Obligation

- ✚ Register as a PAYE payer.
- ✚ Obtain from each employee their respective Tax Code Declaration Form that contains TIN & tax code (P or S). They must advise all the employees who do not have a TIN to obtain one from FRCA.
- ✚ Update their payroll system with the PAYE formula provided in the Income Tax (Withholding Tax) Regulations 2013.
- ✚ Deduct the correct PAYE and Social Responsibility Tax (SRT) from the employment income where applicable.
- ✚ Remit the tax deducted each month by the end of the following month with the Employer Monthly Summary (EMS) in an electronic format.
- ✚ Provide Tax Withholding Certificates to all their employees on or before the last day of February.
- ✚ Keep records to support the computation of tax deducted.

## Flowchart for PAYE as Final Withholding Tax



### ➡ Penalties charged by FRCA

- ✚ Late Payment Penalty – **25%** of PAYE amount unpaid or in any other case, a penalty of 5% for each month of default.
- ✚ Late Lodgment Penalty – **20%** of PAYE of the amount tax payable under the return or a penalty of 5% for each month of default.

### ➡ Offences:

- ✚ Employer is liable to a fine not exceeding **\$15,000.00** or to imprisonment for a term not exceeding **12 months** or to both a fine and imprisonment on any of the following offences:
- ✚ Failure to keep adequate PAYROLL records.
- ✚ Obstructing the tax officials in the performance of their duties.
- ✚ Failure to produce any books or records.

## Calculation of PAYE

### ✚ Tax rates

- Normal tax is levied on **Chargeable income** (*i.e. Total income less deductions*). **There will not be any claims for allowances such as Marital, Child, Elderly and FNPf from 2013.**
- There are separate rates of normal tax for resident and non-resident individuals as per Fourth Schedule of Income Tax Act. Tables in the fourth schedule are as follows:

**RESIDENT INDIVIDUALS AND RESIDENT INDIVIDUAL TRUSTEES****Year of Assessment 2013 and subsequent years**

<b><i>Chargeable Income (\$)</i></b>	<b><i>Tax Payable (\$)</i></b>	<b><i>Social Responsibility Tax</i></b>
0-16000	Nil	
16,001 – 22,000	7% of excess over \$16,000	
22,001 – 50,000	420 + 18% of excess over \$22,000	
50,001 – 270,000	5,460 + 20% of excess over \$50,000	
270,001 – 300,000	49,460 + 20% of excess over \$270,000	23% of excess over \$270,000
300,001 – 350,000	55,460 + 20% of excess over \$300,000	6,900 + 24% of excess over \$300,000
350,001 – 400,000	65,460 + 20% of excess over \$350,000	18,900 + 25% of excess over \$350,000
400,001 – 450,000	75,460 + 20% of excess over \$400,000	31,400 + 26% of the excess over \$400,000
450,001 – 500,000	85,460 + 20% of excess over \$450,000	44,400 + 27% of the excess over \$450,000
500,001 – 1,000,000	95,460 + 20% of excess over \$500,000	57,900 + 28% of the excess over \$500,000
1,000,001 +	195,460 + 20% of excess over \$1,000,000	197,900 + 29% of the excess over \$1,000,000



**NON-RESIDENT INDIVIDUALS AND NON-RESIDENT INDIVIDUAL TRUSTEES****Year of Assessment 2013 and subsequent years**

<b>Chargeable Income (\$)</b>	<b>Tax Payable (\$)</b>	<b>Social Responsibility Tax</b>
0-16000	20% of excess of \$0	
16,001 – 22,000	3,200 + 20% of excess over \$16,000	
22,001 – 50,000	4,400 + 20% of excess over \$22,000	
50,001 – 270,000	10,000 + 20% of excess over \$50,000	
270,001 – 300,000	54,000 + 20% of excess over \$270,000	23% of excess over \$270,000
300,001 – 350,000	60,000 + 20% of excess over \$300,000	6,900 + 24% of excess over \$300,000
350,001 – 400,000	70,000 + 20% of excess over \$350,000	18,900 + 25% of excess over \$350,000
400,001 – 450,000	80,000 + 20% of excess over \$400,000	31,400 + 26% of the excess over \$400,000
450,001 – 500,000	90,000 + 20% of excess over \$450,000	44,400 + 27% of the excess over \$450,000
500,001 – 1,000,000	100,000 + 20% of excess over \$500,000	57,900 + 28% of the excess over \$500,000
1,000,001 +	200,000 + 20% of excess over \$1,000,000	197,900 + 29% of the excess over \$1,000,000

**Illustrative Example:****✚ Example 1**

- Mr. D is entitled to a salary and other cash benefits of \$100,000 for 2014. He is a Fiji resident and is paid monthly. Calculate PAYE payable by Mr. D for income year 2014.

**✚ Solution**

- According to the Normal Tax table for resident taxpayers, PAYE payable for 2014 is:

$$\begin{aligned}
 \text{PAYE Payable} &= \$5,460 + [20\% \times (\$100,000 - \$50,000)] \\
 &= \$5,460 + \$10,000 \\
 &= \$15,460
 \end{aligned}$$

**✚ Example 2**

- Mr. Z is entitled to a salary and other cash benefits of \$18,000 for 2014. He is a Fiji resident and is paid fortnightly. Calculate PAYE payable by Mr. Z for income year 2014.

### **Solution**

- According to the Normal Tax table for resident taxpayers, PAYE payable for 2014 is:

$$\begin{aligned}\text{PAYE Payable} &= 7\% \times [\$18,000 - \$16,000] \\ &= 7\% \times \$2,000 \\ &= \$140\end{aligned}$$

### **Example 3**

- Mr. Z is entitled to a salary and other cash benefits of \$80,000 for 2014. He is a non-resident for tax purpose in Fiji and is paid monthly. Calculate PAYE payable by Mr. Z for income year 2014.

### **Solution**

- According to the Normal Tax table for resident taxpayers, PAYE payable for 2014 is:

$$\begin{aligned}\text{PAYE Payable} &= \$10,000 + [20\% \times (\$80,000 - \$50,000)] \\ &= \$10,000 + \$6,000 \\ &= \$16,000\end{aligned}$$



#### Activity 1.2.1

#### **Short Answer and Calculations:**

1. Define personal Income Tax.
2. Explain what Income tax Act is.
3. Differentiate between Primary and Secondary employment.
4. Explain what Tax Identification Number is. State the purpose served by TIN.
5. Explain the penalties imposed by FRCA for noncompliance of tax.
6. Mrs. Chan is entitled to a salary and other cash benefits of \$200,000 for 2013. She is a Fiji resident and is paid fortnightly. Calculate PAYE payable by Mrs. Chan for income year 2013.
7. Mr. Johnny is a New Zealand resident who is employed by SPC in Suva. He is entitled to a salary and other cash benefits of \$90,000 for 2014. He is a non-resident for tax purpose in Fiji and is paid monthly. Calculate PAYE payable by Mr. Johnny for income year 2014.

## SOCIAL RESPONSIBILITY TAX

- ✚ Is imposed on an individual who has a chargeable income exceeding FJD\$270,000.00.
- ✚ The tax came into effect on 1 January, 2012.

### ➡ Who is responsible for the collection and payment of the tax?

- ✚ Salary and wage earners - employers will make the SRT calculations, deductions and remittances in the same manner as that of PAYE final tax.
- ➡ Salary and wage earners with business income [e.g. rental income, taxi income, bank interest] will be required to either inform their employers of their estimated chargeable income for the year and/or make payments directly to FRCA.

### How is SRT calculated?

- ✚ SRT is computed by applying the rate to the chargeable income. The rates are provided in **the** Fourth Schedule of the Income Tax Act.

### Example 1

- ✚ Mr. X is entitled to a salary and other cash benefits that amount to \$420,000 for tax year 2014. He is a Fiji resident and is paid monthly. Calculate SRT payable by Mr. X for tax year 2014.

### Solution

- ✚ According to the SRT table for resident taxpayers, SRT payable for tax year 2014 is:  
$$\begin{aligned}\text{SRT Payable} &= \$31,400 + [26\% \times (\$420,000 - \$400,000)] \\ &= \$31,400 + \$5,200 \\ &= \$36,600\end{aligned}$$

### ➡ Example 2

Mr. Z is entitled to a salary and other cash benefits that amount to \$420,000 for 2014. He is a non -resident for tax purposes in Fiji and is paid monthly. Calculate SRT payable by Mr. Z for tax year 2014.

### Solution

- According to the SRT table for non - resident taxpayers, SRT payable for tax year 2014 is:  
$$\begin{aligned}\text{SRT Payable} &= \$31,400 + [26\% \times (\$420,000 - \$400,000)] \\ &= \$31,400 + \$5,200 \\ &= \$36,600\end{aligned}$$

### ➡ Example 3

Mr A is entitled to a salary and other cash benefits that amount to \$620,000 for 2014. He is a non -resident for tax purposes in Fiji and is paid monthly. Calculate PAYE and SRT payable by Mr A for tax year 2014 and also for January, 2014.

## Answers

PAYE and SRT payable for tax year 2014:

$$\begin{aligned}\text{PAYE Payable} &= \$100,000 + [20\% \times (\$620,000 - \$500,000)] \\ &= \$100,000 + \$24,000 \\ &= \$124,000\end{aligned}$$

$$\begin{aligned}\text{SRT Payable} &= \$57,900 + [28\% \times (\$620,000 - \$500,000)] \\ &= \$57,900 + \$33,600 \\ &= \$91,500\end{aligned}$$

PAYE and SRT payable for January 2014:

$$\begin{aligned}\text{PAYE Payable} &= \$124,000/12 \\ &= \$10,333.33\end{aligned}$$

$$\begin{aligned}\text{SRT Payable} &= \$91,500/12 \\ &= \$7,625\end{aligned}$$



### Activity 1.2.2

#### A. Short Answers:

1. Define Social Responsibility Tax.
2. State the employer's role in relation to the payment of SRT to the tax department.

#### B. Tax Calculations

3. Mr. Ram is entitled to a salary and other cash benefits that amount to \$354,000 for tax year 2014. He is a Fiji resident and is paid monthly. Calculate SRT payable by Mr. Ram for tax year 2014.
4. Mr. Andrew Chung is entitled to a salary and other cash benefits that amount to \$415,000 for 2013. He is a non-resident for tax purposes in Fiji and is paid monthly. Calculate SRT payable by Mr. A. Chung for tax year 2013.
5. Mr. Tagici is entitled to a salary and other cash benefits that amount to \$385,000 for 2014. He is a non-resident for tax purposes in Fiji and is paid monthly. Calculate PAYE and SRT payable by Mr. A for tax year 2014 and also for January, 2014.
6. Mr. C is remunerated to a salary of 100, 000. He is a Fiji resident and is paid fortnightly. Calculate PAYE and SRT payable by Mr. C for tax year 2014.
7. Mrs. D is entitled to a salary of \$440,000 for 2014. He is a resident for tax purposes in Fiji and is paid fortnightly. Calculate PAYE and SRT payable by Mrs. D for tax year 2014.

## (Form S)

### Example

Mr. Y is employed by XYZ Co. Ltd and XE University Fiji. His primary employment is as a manager in XYZ Co. Ltd whilst his secondary employment is as a part-time tutor at XE University Fiji. He is entitled to a salary of \$30,000 from XYZ Co. Ltd and a salary of \$15,000 from XE University Fiji. XYZ Co. Ltd deducted tax of \$1,860 whilst XE University Fiji deducted tax of \$3,000 at source.

Determine the Tax payable or refundable for 2013.

### Form 'S' Income Tax Returns

<b>Total Income</b> (\$30,000 + \$15,000)	\$45,000
Less Total Exemptions and Deductions	\$ 0
<b>Chargeable Income</b> subject to Normal Tax	\$45,000
Normal Tax Payable	\$ 4,560
Less PAYE deducted at source (\$3000 + \$1860)	\$ 4,860
Social Responsibility Tax Payable	\$ 0
SRT deducted at source	\$ 0
<b>Tax Refund</b>	\$ 300
<b>Tax Payable</b>	

### Note:

- Chargeable Income = Total Income less Total Exemptions and Deductions
- Normal Tax Payable (Compute from schedules in Fourth Schedule)
- Social Responsibility Tax Payable (Compute from Tax Table)
- Tax Refund/Payable = [Normal Tax Payable + Social Responsibility Tax Payable] – [PAYE deducted at source + SRT deducted at source]. If the result is:
  - negative there is a tax refund
  - positive there is tax payable

**“Redundancy payment”** means a bona fide lump sum payment, other than a retiring allowance on the occasion of the termination of employment.

The main features are:

- It is made on termination of employment due to the abolishment of the employee's post.
- The first \$15000 is subject to tax at 0%, the balance is taxed at 15%.
- For the purpose of calculating the portion taxable at 0%, any taxable payment, which will be part of the total redundancy package, must be excluded.
- It does not apply to:
  - Payments made upon lay-off of seasonal employees.
  - Payments made upon completion of a fixed term engagement or upon completion of work specified in a contract.
  - Any contractual payments upon completion of contract.



- Any gratuity payment.
- Payments on retirement.
- Payments considered excessive.

### **Other Specific Tax**

#### **Redundancy payments**

Notwithstanding any other provision of this Act, tax shall be assessed, levied, and paid in respect of any redundancy payment received on or after 1st October 1995 as follows:

- (a) on the first \$15,000 of any such payment at the rate of NIL %;
- (b) on any amount in excess of \$15,000 at the rate of 15%.

### **Illustrative Example**

Mr. G is entitled to a salary of \$40,000 and is a full time employee at X Co Ltd. He is a Fiji resident and is paid monthly. Due to major restructure in the company, X Co Ltd terminated the appointments of 22 employees. One of them was Mr. G. Mr. G received a redundancy package of \$75,000. Calculate tax payable by Mr. G for this payment.

#### **Solution**

$$\begin{aligned}
 \text{Tax Payable} &= (\$75,000 - \$15,000) \times 15\% \\
 &= \$60,000 \times 15\% \\
 &= \$9,000
 \end{aligned}$$



#### **Activity 1.2.3**

1. Define Redundancy Payment.
2. List 2 circumstances where redundancy payment is not applicable.
3. Mrs. Angeline is an accountant at Credit Corporation and is entitled to a salary of \$40,000. She is a Fiji resident and is paid monthly. Due to major restructure in the company, Credit Corporation Ltd dismissed the appointments of 10 employees. Mrs. Angeline was one of the employees and she was compensated with a redundancy package of \$95,000. Calculate tax payable by Mrs. Angeline for this payment.
4. Mr. Sharuk is employed by Carpenters Motors and Fiji National University. He is working full time at Carpenters Motors as an internal auditor earning a salary of \$35000. His secondary employment is as a part-time tutor at Fiji National University where he earns \$10,000 per annum.

<b>Tax Deducted at Source</b>	<b>Amount \$</b>
Carpenters Motors	2760
FNU	2000

Determine the Tax payable or refundable for 2014.

# NATURE OF ACCOUNTING



## Strand Outcome

Discuss the nature, purpose, scope of Accounting, the concepts inherent in Accounting, the characteristics of Accounting data and the career opportunities available in the specialized fields of Accounting.

## Learning Outcomes

- Evaluate the nature of Accounting and the bodies responsible for financial reporting in Fiji.
- Examine the Accounting concepts/Principles/Convention inherent in Accounting and Characteristics of accounting data needed for effective reporting.

STRAND

2

## 2.1 ACCOUNTING THEORY

### Nature of Accounting

- ✚ Accounting is a system for recording, classifying and summarizing financial information and then interpreting the results to various users for decision making.
- ✚ Accounting dates back to 1494 when an Italian monk named Luca Pacioli wrote a book in Mathematics which described the double entry system of book-keeping.
- ✚ Accounting is a flexible system and it changes according to the economic needs of the society.
- ✚ Accounting is a tool to measure the economic activity in monetary terms which evolves when necessary to adapt changes in its environment.
- ✚ Accounting is used by both profit making and non-profit making organization.

### Purpose of Accounting

- ➡ It serves as an information system, providing useful information in report form to various users for decision making.

### Functions of Accounting

- ✚ It involves recording, classifying and summarizing transactions into monetary terms.
- ✚ It provides information about an enterprise to various parties for decision making.
- ✚ It serves as a business language that makes it easier for people to understand the financial affairs of an organization.
- ✚ It provides the data to measure and evaluate the operating results of the business by preparing the financial reports about how a business has performed during the year.

### Roles of Accountants

- ✚ An accountant performs financial functions related to the collection, accuracy, recording, analysis and presentation of a business, organization or company's financial operations.
- ✚ The accountant usually has a variety of administrative roles within a company's operations. In a smaller business, an accountant's role may consist of primarily financial data collection, entry and report generation.
- ✚ Middle to larger sized companies may utilize an accountant as an adviser and financial interpreter, who may present the company's financial data to people within and outside of the business.
- ✚ They provide both **financial** and **non-financial** information to the top management.
- ✚ Generally, the accountant can also deal with third parties, such as vendors, customers and financial institutions.

### Users of Accounting Information

- ✚ Shareholders

- + Investors
- + Creditors.
- + Trade Unions
- + Government
- + Management
- + Employees
- + Public
- + Regulators

### Reasons why users interested in Accounting Reports

1. **Owners/Shareholders** – interested in the profit goals of the business and assess the performance of the management.
2. **Investors** – interested in the rate of return that the business will earn currently and in the future.
3. **Creditors /Suppliers** – measure the credit worthiness of the business and the debt paying ability of the business.
4. **Trade Unions** – assess the job security and wage negotiations of the business for the employees.
5. **Government** – have various uses such as:
  - a. FRCA – to assess and collect tax.
  - b. Labour Department – to assess number of workers employed.
  - c. Fiji Commerce Commission – to know the pricing and trading activities of the enterprise.
  - d. Bureau of Statistics – require data for various purposes.
6. **Management** – to evaluate the performance of the business so that they can implement control, plan and maximize decisions concerning the running of the business.
7. **Employee** – to ensure that business provides wages or salaries on time and good working conditions.
8. **Public** – to see that the consumer's right is at beneficial at all times.
9. **Regulators** – (FIA) ensures that financial statements prepared by Businesses (publicly listed companies) and other entities must comply with the required Accounting Standards.

### 1.0 Specialized fields of Accounting

#### ➡ Cost accounting

- + It provides information to management on controlling the cost of producing the good or service which a business sells.
- + Cost accounting provides the detailed cost information that management needs to control current operations and plan for the future.

#### ➡ Management Accounting

- + It provides management for the guidance of planning, budgeting, cost control, operations and the overall control of the business.

- + It is meant for **internal** use of the business by managers who need to evaluate the performance and provide for future planning.

### ➡ **Financial Accounting**

- + It communicates relevant and useful information to external parties as an aid in decision making.
- + Financial information is based on historical (event) and financial statement is prepared in accordance with Fiji accounting standards.

### ➡ **Social Accounting**

- + is the process of communicating the social and environmental effects of organizations' economic actions to particular interest groups within society.
- + Social accounting is commonly known as corporate social reporting.

### ➡ **Forensic Accounting**

- + Is the use of accounting skills to investigate fraud and to analyze financial information to use in legal proceedings.
- + Forensic accountants also referred to as investigative accountants.

### ➡ **Government Accounting**

- + **Governmental Accounting** is an umbrella term which refers to the various accounting systems used by various public sector entities.

### ○ **Auditing**

- + Auditing is defined as a systematic and independent examination of data, statements, records, operations and performances (financial or otherwise) of an enterprise for a stated purpose.
- + The purpose is then to give an opinion on the adequacy of controls (financial and otherwise) within an environment they audit, to evaluate and improve the effectiveness of risk management, control, and governance processes.
- + Internal and external auditors mostly check the accuracy of the accounting data.

- **Tax Accounting** – deals with accounting that focus on tax issues, which include activities related to filling tax returns and planning future tax commitments.
- **Fiji Accounting Standards** – are the rules and guidelines that assist accountants in the preparation of financial reports. The Fiji Accounting standards has been adopted from the International Accounting Standards.
- **International Financial Reporting Standards (IFRS)** – Most businesses in Fiji are required to use IFRS while preparing the financial reports effective from January 2007.
- **Generally Accepted Accounting Principles** refer to the standard framework of guidelines, conventions, and rules accountants are expected to follow in recording, summarizing, and preparing financial statements in any given country.



### Activity 2.1.1

#### A. Multiple Choice

1. The main function of a management Accounting is to provide information to
  - A. The shareholders
  - B. Creditors of the firm
  - C. Decision makers within the business
  - D. The customers
2. Which of the following is **not** the possible direct user of accounting information?
  - A. Owner
  - B. FRCA
  - C. Police officer
  - D. Supplier

#### B. Short Answer Questions

3. Define Accounting.
4. List some of the specialized fields of accounting.
5. Explain what Fiji Accounting Standards is.
6. Discuss two roles of accountants in a business environment.
7. What is Auditing?
8. State the reason why businesses carry out an audit trail.
9. Give an explanation on why each of the following stakeholders are interested in the business affairs:
  - Owner
  - Supplier
  - Government
  - Banker
  - Shareholders
  - Investors
  - Trade Unions
  - Management
  - Public
  - Regulators
10. Differentiate between social accounting and forensic accounting.



## **Nature and Functions of Authorities that regulate accounting taxation, and auditing profession in Fiji**

### **1. Fiji Institute of Accountants**

- The FIA was established in 1972 in accordance with the FIA Act 1971.
- It is a legal and professional body that regulates the accounting profession and members practicing in Fiji.
- Some of the accounting firms in Fiji are: KPMG, G. Lal & Company, PWC, Aliz Pacific etc.

### **2. Fiji Institute of Auditors**

- Is a body that monitors, educates, controls the activities and regulates the auditing profession or auditors. The Auditor General's office over sees its operations.

### **3. Fiji Tax Agents Board (F.T.A.B)**

- is a legal regulatory body formed under Fiji Income Tax Act and is managed by FRCA to educate, register and monitor the tax agents.

### **4. Fiji Revenue and Customs Authority (FRCA)**

- is assigned the task of collecting regulating and monitoring activities of tax payers.
- is a body that looks after the collection of tax and tax returns.
- Advises the State on matters relating to taxation and customs and excise and liaises with appropriate Ministries and statutory bodies on such matters.
- Exercises all functions and performs all duties carried out by the former Inland Revenue Department and the Fiji Islands Customs Service.

**5. Office of Auditor General** – looks into the auditing of government departments in Fiji.



## Accounting Concepts

- It includes those basic assumptions or conditions upon which the science of accounting is based.

### ➡ **Business Entity Convention**

- ✚ It is where business is regarded as separate and distinct from its owners, creditors and management.
- ✚ If the owner operates several different businesses, the records of each business should be kept separately.
- ✚ However, under the law, sole traders and partnerships are personally liable to pay the debts of the business. In a limited liability company, the law recognizes the company as a separate legal entity from its owners.

### ➡ **Legal Entity**

- ✚ An association, corporation, partnership, proprietorship, trust, or individual that has legal standing in the eyes of law.
- ✚ A legal entity has legal capacity to enter into agreements or contracts, assume obligations, incur and pay debts, sue and be sued in its own right, and to be held responsible for its actions.

### ➡ **Double Entry Principle**

- ✚ It states that for every debit entry there should be a corresponding credit entry.

### ➡ **Historical Cost Concept**

- ✚ It states that all assets and liabilities are recorded at their original or historical cost.
- ✚ It does not take into account the effect of inflation.
- ✚ It is objective and is considered to be a much more verifiable quality than its current value.

### ➡ **Matching Concept**

- ✚ It requires that all expenses incurred during the period should be matched with the revenue earned during that period so that a correct profit is determined.

### ➡ **Accounting Period Concept (Periodicity)**

- ✚ It assumes that the life of the business should be divided into equal arbitrary periods in order to measure the operating results of the business.

### ➡ **Going Concern Concept (Continuity of Activity)**

- ✚ It assumes that a business will continue to operate indefinitely in the near future unless it is on the verge of liquidation.

### ➡ **Money Measurement Concept**

- ✚ It states that all transactions should be recorded in terms of money.
- ✚ Events or transactions which cannot be expressed in money do not find a place in the books of accounts though they may be very useful for the business.

### ➡ **Realization Principle**

- ✚ It states that a profit should only be brought into account when it is actually realized.
- ✚ It means that a profit is realized when the earning process is completed.

### ➡ **Consistency Concept**

- ✚ It states that a business should use the same accounting policies or methods from one period to the next so that financial statements can be compared from one period to the next.
- ✚ It ensures that the depreciation method and the stock valuation method should remain the same for each accounting period.

### ➡ **Conservatism (Prudence)**

- ✚ It requires that accountants should “**anticipate no profit but provide for all possible losses**”, while recording transactions.
- ✚ An example of the application of conservatism is the valuing of inventories at the cost price or the market price, **whichever is less**.

### ➡ **Materiality**

- ✚ It relates to the relative significance of the financial data which must be disclosed in the financial statements.

### ➡ **Accruals**

- ✚ Assumes that revenues and costs are recognized and included in the financial statements as they are accrued or earned or incurred and not as they are paid or received.

### ➡ **Dual Aspect**

- ✚ States that the double entry system requires that for all transactions, every debit in an account should match equally by corresponding credit entries in the contra account.

### ➡ **Substance Over Form**

- ✚ States that some transactions have a legal form which is different from the underlying commercial reality or substance.

### ➡ **Disclosure**

- ✚ It requires that financial statements of a business should reveal all relevant information relating to the business that can make an informed decision.

## **Characteristics of Accounting Data**

### **Relevance**

Accounting data should be capable of making a difference in a decision in order to be useful.

### **Understandability**

Accounting data should be understandable and simple to the users of the accounting information.

### **Verifiability**

Accounting data should be verifiable or it should be examinable by the users of the accounting data. Two accountants examining the same report should come to the same conclusion.

### **Neutrality**

Accounting data should be free of bias and should be helpful to the needs of the common people.

### **Timeliness**

Accounting data should be available on time for decision making without delay.

### **Reliability**

Accounting data should be free of any errors and it should be used for useful decision making.

### **Quantifiability**

Accounting data is to be quantifiable for reporting purposes. Data to be expressed in words and in numbers.

### **Comparability**

Accounting data should be compared with similar years or with similar accounting firms.

## **Business Ethics for Financial Reporting**

► Ethics in accounting are concerned with how to make good and moral choices with regards to the preparation, presentation and disclosure of financial information. The four major ethics that accountants need to follow are:

- Honesty
- Transparency
- Accountability
- Completeness



### **Activity 2.1.2**

#### **A. Multiple Choice**

1. Which of the following is the characteristic of accounting data?
  - A. Consistency
  - B. Continuity
  - C. Subjectivity
  - D. Timeliness

2. Comparability in the preparation of accounting information implies the
- A. Accuracy and reliability of information in accounting reports.
  - B. Equal length of accounting periods used for the accounting reports.
  - C. Use of the same accounting procedures in the preparation of accounting reports.
  - D. Ability of users to identify similarities and differences between information in accounting reports.
3. The accounting concept that demonstrates that accountants should be cautious by dealing with profits/losses is
- A. Disclosure concept
  - B. Going concern
  - C. Conservatism concept
  - D. Matching concept

**B. Short Answers**

1. Define Fiji Accounting Standards.
2. Name three firms in Fiji which provides professional accounting services.
3. State the functions of the following institutions in Fiji.  
(Research on the web and present to the class)
  - FRCA
  - FIA
  - Fiji Tax Agents Board
  - Institute of Auditors in Fiji
  - Office of Auditor General
4. Identify the characteristic which best describes each situation below:
  - i. If financial reports are prepared for untrained users, the accountant should ensure that the reports are as simple as possible.
  - ii. In order to provide the most appropriate information to management, accountants must know the purpose of the management's decisions.
  - iii. When two or more different accountants measure the result of a business transaction both should come to a similar conclusion.
5. Explain why the following group of users would be interested in the financial reports of a business:
  - i. Creditors
  - ii. Employees
  - iii. FRCA
6. Explain the difference between Accounting Period and Accounting Entity concept.

7. Listed below are some of the accounting concepts and conventions. Select the most likely answer for each of the four accounting information numbered (a) to (d)

<b>Going Concern</b>	<b>Consistency</b>	<b>Historical Cost</b>
<b>Conservatism</b>	<b>Accounting Entity</b>	<b>Disclosure</b>

### Additional Information

- a) The owner made payment for his son's wedding from business account.
- b) The business assumes to remain in existence into the foreseeable future.
- c) The business continued to use straight line method of depreciation for the past two years.
- d) Do not count the chickens before they are hatched. Always understate profits.

7. Match the characteristics in Column A with the best description in Column B

<b>Column A</b>	<b>Column B</b>
1. Matching Principle	a. They interested in the financial statements of the business to see how effective their policies have been.
2. Materiality	b. Shows the financial performance of the business.
3. Auditor	c. Provides financial information to the external decision makers.
4. Neutrality	d. Income and expenses of a given period to be match with one another.
5. Quantifiability	e. Treatment of an item depends on its importance and relevance to the business.
6. Financial Accounting	f. Accounting data should not only be expressed in words but in numbers also.
7. Managers	g. Accounting data is free from bias to suit the need of the user group.
8. Fiji Institute of Accountants	h. Checks the accuracy of the accounting records.
9. Revenue Statement	i. The financial affairs of the owner is separate and distinct from the business.
10. Accounting Entity	j. Premier body that regulates the Accounting profession.

## 2.2 CAREERS IN ACCOUNTING



The following are **some of the careers paths** available for accounting graduates:

### **Accountants**

- ✚ An **accountant** is a practitioner of accountancy, which is the measurement, disclosure or provision of assurance about financial information that helps managers, investors, tax authorities and others make decisions about allocating business resources.

### **Chartered Accountants**

- ✚ They work in all fields of business and finance, including audit, taxation, financial and general management. Some are engaged in public practice work, others work in the private sector and some are employed by government bodies.
- ✚ Chartered Accountants are those who have completed all requirements of FIA and are licensed practitioners offering advisory services on accountancy.

### ➡ **Auditors**

- ✚ Are professionals who check the accuracy and reliability of the accounting data.
- ✚ They give an opinion on the adequacy of controls (financial and otherwise) within an environment they audit, to evaluate and improve the effectiveness of risk management, control, and governance processes.
- ✚ **Internal Auditors** are appointed within a firm.
- ✚ An **external auditor** is an audit professional who performs an audit in accordance with specific laws or rules on the financial statements of a company, government entity, other legal entity or organization, and who is independent of the entity being audited.

### ➡ **Bank Officer**

- ✚ Bank officers receive and pay out money and assist customers with loans, foreign currency exchange and investments.
- ✚ Bank officers may perform the following tasks:

- identify customer needs and refer customers to appropriate banking services and specialists.
- accept money or cheques deposited by customers, verify records and receipts, and credit customers' accounts.
- pay money to customers according to advice slips, cheques or negotiable documents, and debit customers' accounts.
- conduct foreign currency transactions for overseas travelers.
- balance cash and advise supervisors of cash position or discrepancies.
- open and close accounts for customers.

#### **Bank Teller/Customer Service Officer**

- A bank teller/customer service officer sells and administers bank products and services, handles cash and processes personal and business credit cards, overdraft and personal loan applications.

#### **Credit Officer (Lending/Loans Officer)**

- A credit officer (lending/loans officer) assesses the viability and credit risk of business and consumer loan proposals, and controls and processes accounts.

#### **Accounts Officer**

- With proven financial and management accounting experience, they prepare VAT, FNPf, Payroll, PAYE etc.
- Must be a team player with excellent communication skills

### **Payroll Officer**

#### Payroll officers may do some or all of the following:

- Calculate pay, tax, and superannuation deductions for staff.
- Check the working hours for staff, and what leave they've taken.
- Arrange for staff to be paid.
- Keep staff records up to date.
- Ensure that the organisation complies with relevant legislation.

#### **Skills and knowledge**

#### Payroll officers need to have knowledge of:

- basic accounting and payment systems and scales.
- the tax system.
- Employment legislation.

### **Stock Controller**

#### A stock controller may perform the following duties:

- Processing purchase orders.
- Receiving Deliveries.
- Reconciling Delivery notes with purchase orders.
- Recording serial numbers where applicable.
- Place stock in designated areas for ongoing projects.
- Monthly stock take and reconciliation of stock.



### ➡ **Financial Controller**

- ✚ The role of a financial controller involves overseeing the accounts department and making sure everything runs smoothly.

### ➡ **Financial Analyst**

- ✚ Someone who performs the task of financial analysis for external or internal client.

### ➡ **School Teacher**

- ✚ Teaches accounting concepts and principles and prepares students for tertiary studies.

### ➡ **Chief Financial Officer**

- ✚ Responsible for managing the financial risks of the firm. Qualification: Must be a CA and have MBA degree.

### ➡ **Tax Agents**

- ✚ Are involved in preparing the income tax returns and VAT returns for taxpayers and businesses. Is a professional public practitioner.

## **Qualifications**

The table below shows the qualification required to become an accountant or to adopt any career opportunities in the Commerce Industry:

<b>Occupation</b>	<b>Qualification</b>	<b>Training Program</b>	<b>Tertiary Institution</b>	<b>Cost of training</b>	<b>Financial sources</b>
Accountant, Auditor Tax Agents Bank Officer Financial Controller Stock Controller Financial Analyst	Bachelor of Commerce	Accounting / Economics / IT / Management	USP FNU UniFij	\$20 000	Scholarship Savings FNPf Loan
Payroll Officer Account Officer	Diploma in Accounting	Accounting / IT	USP FNU UniFij	\$10 000	Scholarship Savings FNPf Loan
School Teacher	Graduate Certificate in Education	Accounting / Economics	USP FNU	\$20 000	Scholarship Savings FNPf Loan
Chief Financial Officer	Bachelor of Commerce MBA/MCom	Accounting / Management / IT	USP FNU UniFij	\$20 000	Scholarship Savings FNPf Loan

### ➡ **The potential entrepreneurial activities that one can concentrate on as a career option:**

- ✚ Operating Small business enterprises such as selling handicrafts and mats, operating a small canteen, tailoring, selling roti parcels.
- ✚ Business starts from small and grows big.
- ✚ Capital sources for small enterprises: Own savings and loan from FDB.



### Activity 2.2.1

#### Short Answers

1. Identify some of the career opportunities available in Accounting.
2. Describe two important role or duties of a bank officer.
3. Find out about the requirements to become a full member of FIA.
4. State the qualification required to become a chartered accountant.
5. List the duties performed by an accountant.

# FINANCIAL ACCOUNTING AND THE ACCOUNTING PROCESS



## Strand Outcome

Research and describe the different types of business ownership and outline the procedures of registering a sole proprietor business and eventually apply Accounting Principles and processes to financial transaction of sole proprietor from preparation of Accounting Equation, the Analysis Chart then to the Trial Balance

## Learning Outcomes

- Explore and discuss the different forms of business ownership
- Evaluate the legislations governing the registration and regulation of Sole Proprietors in Fiji
- Analyze the effects of transactions on the different types of Accounting Equation and write possible transactions from given effects.
- Analyze transactions in the Analysis Chart using the Double Entry Concept to process financial information accurately.
- Explore the procedure in using the Analysis Chart to prepare ledger accounts, Trial Balance and discuss the errors not revealed by a trial Balance

STRAND

3

### 3.1 BUSINESS OWNERSHIP

#### Types of Business Ownerships

Six types of business entities found in Fiji.



#### 1. Sole-trader

**Definition-** a business is managed and run by only **one** person.

**No of owners:** one

**Examples:** Abdul's Store, Subhash's Taxis, Dr. Peter's Surgery

**Features:** The major characteristic is that one person operates the business.

**Aim/ Motive:** to make as much profit as possible.

**Sources of Capital:** Personal Savings, FNPF, Loan from Bank/ Relatives.

**Legal document:** business licence .

**Owners are known as:** sole trader or sole – proprietor.

#### Advantages:

1. Easy to form since there is no additional legal requirement except getting the business registered.
2. Boss of your own- decisions made more quickly.
3. There is no conflict of interest
4. The owner takes all the profit.
5. The financial details are kept private .

#### Disadvantages:

1. The owner has **unlimited liability**. This means if the business becomes bankrupt, the owner will be personally liable to pay the debts of the business i.e his personal assets can be taken to pay off the business debt.
2. Limited capital for the expansion of the business.
3. Sole trader is not a legal entity but follows separate entity concept.
4. The owner has to bear all loss.
5. Limited Life.

Proprietorship section – Sole proprietor		\$
Opening capital		xxx
Add net profit		xxx
		xxx
Less drawings		xxx
Closing Capital/ Proprietorship		xxxxx

## Legal Procedure for the formation of Sole Proprietors in Fiji

### 1.0 Registering a Business

- ➡ To establish a business, it should be properly registered.
- ➡ A Business License should be obtained by registering for any type of business.

### 2.0 Procedures for Registering a Business

- ➡ Formation
  - ✚ A group of interested people or an individual decides to establish a business.
  - ✚ Interested people are said to be business minded individuals whose main motive is to make profit.
- ➡ Business License
  - ✚ The Registrar will issue a business license as an official document for the establishment of an enterprise.
  - ✚ It is a legal document which gives an enterprise the permit to operate.
- ➡ TIN Registration
  - ✚ A Tax Identification Number [TIN] should be obtained from the Fiji Revenue and Customs Authority.
  - ✚ This is an exclusive number which is used by FRCA for all data input and taxation purposes.
- ➡ VAT Registration
  - ✚ A business should also be registered for Value Added Tax [VAT] to FRCA.
- ➡ Bank Account
  - ✚ It is an account that is used for the cash flow operation of the business.
  - ✚ The business may decide to choose any bank of their choice.
- ➡ Employment of Workers
  - ✚ The business decides on the number of people needed for the successful operation of the business.
- ➡ FNPF Registration
  - ✚ Business is required to register for Fiji National Provident Fund [FNPF].
  - ✚ This is also compulsory for the workers to be FNPF registered so that the compulsory superannuation deduction takes place.

## 2. Partnership

**Definition** – a business run and managed by at least 2 people, maximum 25.

**Number of owners**- 2 to 25.

**Example:** Patel Singh and Associates.

**Features:** Partners need to prepare a document known as partnership agreement. This agreement includes a description of rights, obligations and responsibilities of each partner.

**Aim/ Motive:** to make as much profit as possible.

**Sources of capital:** partner's contribution, loan from banks, FNPF etc.

**Legal document:** Partnership Act.

**Owners are known as:** Partners.





## Partnership Documents

### 1. Partnership Agreement (Partnership deed)

✚ is agreement between the partners on the running of the partnership business.

#### Clauses of Partnership Agreement

- Names of the partners.
- Name of the business.
- Nature of the business.
- Duties of the partners.
- How profits and losses are to be shared.
- Capital contribution by each partner.

### 2. Partnership Act

✚ It is a legal document binding all the partners in the absence of partnership agreement.

#### Clauses of Partnership Act

- Partners share profits and losses equally.
- Partners are not entitled to salary.
- Partners are not entitled to any interest on capital invested.
- Partners are entitled to 5% interest on loans made to the business.
- All partners are entitled to part in the management of the business.

#### Advantages:

- More capital contributed than sole-trader business. Each partner would be contributing a pre-agreed sum of money as equity.
- More partners mean more skills and expertise of the partners.
- Workload could be shared among the partners.
- Partners may also get salaries if they are working in the business.
- Losses are shared amongst the partners.

#### Disadvantages

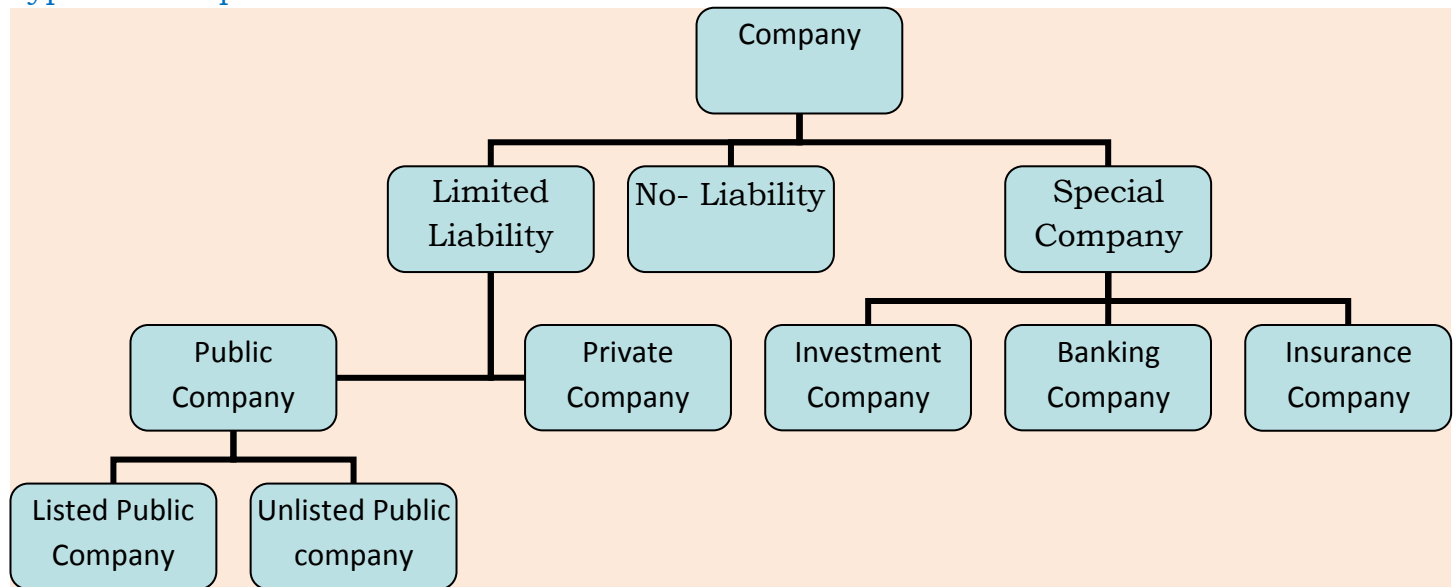
- Partnership also has unlimited liability.
- Profits are shared amongst the partners .
- Conflict of interest may arise among the partners.
- Relatively lower capital would be raised compared to companies.
- Limited life.

Proprietorship section – Partnership		\$	\$
<b>Current account – Lusy</b>		<b>3500</b>	
	<b>Vijay</b>	<b><u>2500</u></b>	<b>6000</b>
<b>Capital account- Lusy</b>		<b>1800</b>	
	<b>Vijay</b>	<b><u>2200</u></b>	<b><u>4000</u></b>
<b>Closing Capital/ Proprietorship</b>			<b><u>10000</u></b>

### 3. Companies

A company is a business organisation established by being registered under the companies Act.

#### Types of Companies



#### **Limited liability companies**

- ✚ are those for which shareholders are liable for debts to the value of their shareholding.

#### **Key features of limited liability companies ( private and public companies)**

- A limited liability company is owned by its shareholders.
- Separate legal entity from its shareholders.

#### **The two legal documents of the Companies are:**

##### ➡ **Memorandum of Association**

- it defines the objects and powers of the company.
- is basically the constitution of the company.

##### ✚ **Clauses of Memorandum of Association**

1. Name of the company, followed by word **Ltd.**
2. Liability of the shareholders is limited.
3. Amount of shares and the kind of shares the company can issue.
4. Objects and powers of the company i.e. purpose of forming the company.
5. Place where the company is registered.

##### ➡ **Articles of Association**

- ✚ have rules and regulations governing the internal management of the company.



## **Clauses of Articles of Association**

1. The powers and duties of the directors.
2. The rules on how the company is to be run.
3. Voting rights of the shareholders.
4. The calling of annual general meetings.
5. Issue and transfer of shares.
6. How profits and losses will be distributed.

## **The Certificate of Incorporation**

If the registrar is satisfied with the documents, he will register the company and issue a Certificate of Incorporation for its legal existence. This certificate gives permission to the company to commence business. There are no further formalities required to start a company.

- Company is run by the directors of the company.
- Directors are elected by the shareholders at the company's AGM.
- Name of the company will end with the term 'limited'.

## **Private Company**

**Definition-** are companies where shares are sold to family members only.

**Number of persons-** 2 to 25 shareholders

**Example-** Navin & Sons Co. Ltd.

### **Features**

- + Private companies are registered as limited liability companies.
- + Accounts are properly kept and audited annually.

**Aim/Motive-** to make as much profit as possible.

**Sources of capital-** contributions from members of the same family, Borrow from financial institutions.

**Legal document:** Articles of association and Memorandum of Association.

**Owners are known as:** shareholders .

## **Advantages**

1. Limited liability.
2. Private companies have greater potential to raise capital than sole-traders or partnerships.
3. Unlike public companies, private companies are not required to publish their audited annual reports.

## **Disadvantages**

1. Shares are issued only to family members.
2. Raise lower capital in comparison to public companies.

## Public companies

**Listed public companies**- these are companies whose shares can be purchased by any person from the stock exchange. A stock exchange is an organization where shares of companies are traded. E.g **South Pacific Stock Exchange**. Examples of some listed companies are: Flour Mills of Fiji Ltd, ATH Ltd, Fijian Holdings Ltd etc.

**Unlisted public companies**- are public companies that are not listed on the stock exchange. They sell shares to the general public.

**Number of owners**- minimum of seven shareholders.

### **Features**

- ✓ For listed companies, people could buy shares from the stock exchange.
- ✓ For unlisted companies, shares are sold through stockbrokers.
- ✓ In both cases, board of directors controls the company.

**Aim/motive**- make as much profit as possible.

**Source of capital**- is the money received through issue of shares to the public. An external borrowing to fund expansion also raises capital for the company.

**Legal document:** Articles of Association and Memorandum of Association.

### **Authorised capital**

- is the maximum amount of money the company can raise by selling shares as stated in the memorandum of association.

### **Authorised shares**

- is the maximum amount of shares the company can sell as stated in the memorandum of association.

### **Issued capital**

- is the portion of authorised capital which has been issued or sold to the public.

### **Unissued Capital**

- is the portion of authorised capital which has not been issued or sold to the shareholders.
- Authorised capital – Issued capital = Unissued Capital.

### **Par Value**

- is the selling price per share.

### **Paid- Up Capital**

- is the amount of money actually received by selling the shares to the public.

### **Shares**

- it is the authorised capital divided into smaller portions/ units.

### **Retained Earnings/ Unappropriated profits**

- profits which are kept by the company and not distributed as dividends for future use of the company.

## Dividends

- are profits distributed to the shareholders on the basis of their shares .

## The Two Types of Shares Commonly Traded:

### 1. Preference Shares

- are shares that carry preferential rights over ordinary shares.
- Preference shareholders receive dividends before the ordinary shareholders and at a fixed rate.

### 2. Ordinary Shares

- are entitled to receive their dividends after the payments have been made on preference shares.
- Dividend paid on ordinary shares vary from year to year.

## Advantages of a Company

1. Shareholders are responsible for the debts of the company only up to the value of their shares.
2. Public companies can raise more capital in the market through issue of new shares.
3. Shareholders do not have to pay tax on their dividend earnings.
4. Companies have a continuous life despite the death or withdrawal of any shareholder.

## Disadvantages

1. More expensive to establish. They will have to abide numerous conditions before they can be listed on the stock exchange.
2. There is loss of control since the shareholders do not have day to day control in the operations of the company.
3. More difficult to manage compared to private companies.
4. Business profits are taxable.
5. Audited financial statements need to be established in annual reports. This places the companies to public scrutiny and competitors can get important business information. Scrutiny means that the public can examine the accounts of the company and raise issues that may concern them.

## Example:

Proprietorship section – Companies		\$
<b>Shareholders Fund Section</b>		
<i>Authorized capital</i>		
500 000 \$1 ordinary shares		500 000
<i>Issued and Paid- up Capital</i>		
280 000 shares paid up to \$0.75		210 000
<b>Retained earnings</b>		<u>60 000</u>
<b>Total Shareholders Fund</b>		<u>270 000</u>

- + State the par value of the share.  
\$1.00
- + What is the number of shares issued to the shareholders?  
280000
- + How much more capital can the company raise from the shareholders?  
\$70000
- + What is the value of Total shareholders Fund?  
\$270000

#### 4. Statutory Authorities/ Public Enterprises

**Definition-** These are organizations established by the government under law/statute to produce and distribute certain goods and services.

**Number of owners-** government only.

**Example-**Housing Authority, all towns and city councils.

**Features**

- ✓ Other than the municipal councils, all other statutory authorities are controlled by board of directors appointed by the government.

**Aim/motive-**some public enterprises are aimed at providing goods and services which the private sector cannot produce at all, or which the private sector cannot produce in sufficient quantities.

**Sources of capital-** main capital contribution comes from the government budgetary grants. Enterprises can also raise funds from external sources like banks.

#### **Advantages**

1. Ensure continuity of supply of essential goods and services.
2. Provides goods and services to the community at a relatively lower cost.
3. Controlled by the government so conflict of interest tends to be lower than other forms of business.

#### **Disadvantages**

1. Unqualified officers on the board of the enterprises. Leads to inefficiencies and rising cost of production of goods and services.
2. Public enterprises tend to be the only providers of certain types of goods and services. Lack of competition lends to inefficiencies.

#### 5.Non Trading Organisations (Clubs)

**Definition-** these are associations formed by groups of people with common interests.

**Number of persons-** any number of person can be members.

**Example-** Fiji Council for Social Services, Fiji Red Cross Society, USP students association, Fiji Sports Club, Vatuwaqa Soccer Association, etc.

**Aim/motive** – is to provide services to its members. Also aims to raise funds and attract donations to help their members and the needy people of the society.

**Sources of capital** – subscription from the members or donations and proceeds from fundraising activities.

**Legal Document:** constitution.

**Owners are known as:** members.

## Features

- Is controlled by elective executives. Such executives could include a president, a secretary, a treasurer and a set of committee members. Some clubs are controlled by people who are called trustees.
- An independent auditor is required to audit the financial statements. Members need to get a true and fair picture of day to day running of the club.
- Clubs and societies may make profits in the form of surpluses.
- Organisation has a set of rules or a constitution to conduct its activities.

## Advantages

1. Provides goods and services to the people and the community without a profit motive.

## Disadvantages

1. Conflicts may arise within the executive committee members.
2. Raising capital is a major problem.

Proprietorship section : Non – Trading Concern		\$
<b>Accumulated Fund</b>		
<b>Opening Accumulated fund</b>		<b>29 500</b>
<b>Add Surplus</b>		<b><u>5 400</u></b>
<b>Closing Accumulated Fund</b>		<b><u>34 900</u></b>

## 6. Co-operatives

**Definition-** A co-operative is an organization formed by a group of people who come together with some specific purpose in mind.

**Number of persons** – minimum of 10 members.

**Example** – FTU (CTCL)

**Features:** co-operatives can be limited liability companies or unincorporated associations.

**Aim/Motive-** main aim is to provide services to its members and make profits.

**Source of capital-** contribution from the members. Other sources can be donations and fundraising activities.

## Advantages

1. The members share the profits made among them.
2. By operating as a co-operative, members learn more skills.

## Disadvantages

1. Sometimes conflict of interest arises between members.
2. Difficult to raise more capital for expansion.



### Activity 3.1.1

#### A. Multiple Choice

1. A sole trader business is run by
  - A. 3-5 persons.
  - B. 1 person.
  - C. 10 persons.
  - D. 2-25 persons.
2. The legal requirement needed to operate a sole trader business is
  - A. Memorandum of association.
  - B. Property title.
  - C. Business License.
  - D. Business document.
3. Which of the following is an advantage of a partnership business?
  - A. Own boss.
  - B. Limited liability.
  - C. Conflicts between partners.
  - D. More capital compared to sole trader.
4. Which business entity in Fiji requires external auditors to verify and certify the financial records as “true and fair” statement of affairs?
  - A. partnership.
  - B. Sole – proprietor.
  - C. private company.
  - D. public limited Liability Company.
5. Which one of the following types of business must have at least 2-25 owners?
  - A. company
  - B. partnership
  - C. sole-Proprietor
  - D. public company

6. A public corporation is established by means of:
- A. the issuing of shares.
  - B. the issuing of debentures.
  - C. an Act of parliament.
  - D. a memorandum of association.
7. Which one of the following types of business organizations would be formed by the issue of shares?
- A. Bihari's General Store
  - B. Youths Squash Club
  - C. Khan and Chung Associates
  - D. Fiji Farmers Food Co Ltd
8. Limited liability means
- A. a company does not have to pay its debts.
  - B. shareholders only pay for part of their debts.
  - C. shareholders liability is limited to the cost of their shares.
  - D. shareholders liability is limited to the debts of the company.

### B. Short Answer Questions

1. Define the following terms:
  - + Partnership Agreement
  - + Limited Liability
  - + Cooperatives
  - + Authorized Capital
2. Explain why the proprietorship section in the balance sheet of non – trading concern is shown as Accumulated Fund or Member's Fund?
3. List two types of business organization which has limited liability.
4. List two organizations in which drawing is not allowed.
5. From the box below, choose the **type of business** that best matches each of the features of the business entity given.

Sole trader  
Partnership  
Company  
Clubs and society



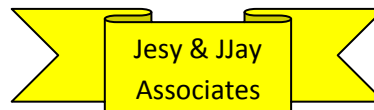
- i. This business is treated as a person in the eyes of the law. It can be sued and can sue people.
- ii. The aim of the organization is to serve the people.
- iii. The owners are mutually liable for the debts of the business.
- iv. The growth of the business is limited to the owner's personal wealth and capacity to raise funds.

6. Given below are four different types of business ownership.

**Figure 1**



**Figure 2**



**Figure 3**



**Figure 4**



**Required:**

**Study the business ownership given above and answer the questions that follows.**

- i. Identify one disadvantage of the business organization in figure 2.
- ii. Identify one characteristic of the business organization in figure 4.
- iii. Which of the following business ownership has unlimited liability?
- iv. Define the term legal entity in relation to business organization in figure 3.

7. Given below are the types of business entities in Fiji. Select from the list the appropriate type of business for each of the following statements numbered (i) – (iv)

<b>Sole Proprietorship</b>	<b>Partnership</b>	<b>Private Companies</b>
<b>Clubs and Association</b>	<b>Public Companies</b>	

- i) The simplest and most common type of business owned and managed by the owner having limited capital to expand the business.
- ii) Has got free transfer of shares and it is compulsory to have its accounts audited annually.
- iii) It has a legal document that is followed when there is misunderstanding amongst the owners recognizing deed of agreement.
- iv) Its major source of revenue is from donation and subscription and which restricts any form of drawings .

8. Classify the following characteristics of business organizations under the heading **Sole- Trader, Partnership, Companies and Non – Trading Concern**

- a) Freedom of ownership.
- b) Death of one of its members will mean the business has to be dissolved.
- c) The legal document is the Memorandum of association.
- d) In the of bankruptcy the owners liability is limited to what he owes to the business.
- e) Can raise larger amounts of capital by issuing shares.
- f) Unlimited liability of the owner.
- g) Proprietorship comprises of accumulated funds.
- h) Must have at least seven members.
- i) External audit a requirement.
- j) The business is managed and controlled by the Board of Directors.
- k) Profits and losses are shared according to the agreement amongst its members.
- l) Its motive is not to make profits but serve the public.
- m) Is a business which buys and sells shares through stock exchange.

### C. Calculations

1. Given below is an extract from the balance sheet of ABC Limited as at 31<sup>st</sup> Dec 2012.

<b>Authorized capital</b>	
200 000 ordinary shares of \$2 each	\$400 000
<b>Issued and Paid –up Capital</b>	
175 000 ordinary shares paid at \$1.00	\$175 000
Retained Earnings	\$45 000

**Required:** Use the information to answer the following questions.

- What is the value of Authorized Capital?
  - How many shares are yet to be issued?
  - Calculate the value of unissued shares.
  - Calculate the value of the total Shareholders Fund for the company.
  - What is the par value of a share?
  - State one advantage of a company type of business.
  - Define the term shareholders fund.
- 2.

Authorized capital	Issued shares	Par value	Paid –up capital per share	Retained earnings
a) 300 000	120 000	\$ 1.00	\$ 0.60	\$ 26 000
b) 80 000	40 000	\$ 1.50	\$ 1.20	\$ 10 000

Draw up the **Shareholders Fund Section** as it would appear in the Balance Sheet of a Company.

3. Given below is the extract of Timoci Ltd as at 31<sup>st</sup> December 2014.

<b>Shareholders Fund</b>	
<b>Authorized capital</b>	
1000 000 ordinary shares at \$2 each	\$2 000 000
<b>Issued and Paid – up capital</b>	
300 000 \$2 ordinary shares paid at 1.50	450 000
Retained earnings	<u>80 000</u>
<b>Total Shareholders Fund</b>	<u>530 000</u>

**Required:**

- What is the value of the Net Assets of the Company?
- How much more per share could existing shareholders be asked to pay?
- Find the value of authorized capital.
- How many more shares is the company entitled to issue?
- Find the par value of the share?
- State what is meant by the term authorized capital.
- What is the value of unissued capital?
- If a shareholder bought 600 shares when they were issued. The company goes into liquidation. How much more money must the shareholder pay? Why?
- In what document is the authorized capital specified.
- What is the other name for retained earnings?

## 3.2 ACCOUNTING EQUATIONS



### Transactions

In accounting, it is any financial event or condition that is recorded in the book of accounts.

➡ There are **four** types of transactions:

#### + Cash Transactions

- Cash transactions are ones that are settled immediately by cash or cheque. Words such as cash, pays, paid, received cheque, withdrew, contributed, and invested in a transaction indicate that it is a cash transaction. Cash transactions may be classified into cash receipts and cash payments.
  - **Cash Receipts**
  - Cash receipts are accounted for by debiting cash / bank ledger to recognize the increase in the asset.
  - **Cash Payments**
  - Cash payments are accounted for by crediting the cash / bank ledger to account for the decrease in the asset.

#### + Credit Transactions

- A contractual agreement in which a borrower receives something of value now and agrees to repay the lender at some date in the future, generally with interest. The term also refers to the borrowing capacity of an individual or company.
- There is no cash involved; cash account will not be affected. Eg: Sold goods to Salvin \$100.

#### + Revenue Transactions

- Revenue transactions are those that are involved with the profit making activity - the goods sold or materials purchased and the incidental costs that are incurred while doing the business.
- **Revenue Expenditure** – Expenses incurred to meet daily expenses either cash or credit. E.g. Paid wages \$40.

#### + Capital Transactions

- Capital Expenditure is those that involve buying of fixed assets and paying liabilities. E.g: the purchase of a machine. This would not appear in the profit and loss account, but would be reflected in the balance sheet.
- **Capital Receipts** – where cash is received due to sale of fixed assts. Eg Sold old Van for cash \$4000.

### Accounting Equation

➡ It is the relationship between the assets, liabilities and the proprietorship.

- ➡ It represents the equality of assets on one side with the claims of creditors and the owners on the other side.

The owner's claim on assets is called **capital** or **owner's equity** and the outsiders claim on assets is called the **liability**.



### **Importance of Accounting Equation**

- is a device that provides a check and balances for each transaction.
- it also facilitates the preparation of financial statements.
- is based on the double entry system.

### **Basic Accounting Equation**

- ➡ The basic accounting equation is expressed in this way:

$$\text{ASSETS} = \text{LIABILITIES} + \text{PROPRIETORSHIP}$$

*Funds **used** by the business = Funds **supplied** by outsiders + Funds **supplied** by the owners*

- ➡ The equation can be further interpreted in many ways:

1. **Assets = Liabilities + Proprietorship**
2. **Proprietorship = Assets – Liabilities**
3. **Liabilities = Assets – Proprietorship**

### **Extended Accounting Equation**

- ➡ The extended accounting equation is expressed in this way:

$$\text{ASSETS} + \text{EXPENSES} = \text{LIABILITIES} + \text{PROPRIETORSHIP} + \text{REVENUE}$$

*Funds used by the business = Funds supplied by outsiders + Funds supplied by the owners*

### **NB**

***Students to recap Year 9 & 10 notes on Source documents and definitions for A,E,L,P,R in order to interpret the transactions.***

### **Part A**

**Showing the Effect of transactions on the Basic and Extended Accounting Equation.**

### Example

The following transactions relate to the business of Georgia

1. Georgia commenced business with \$5000.
2. Purchased goods for cash \$600.
3. Bought furniture on credit \$1000.
4. Sold goods for cash \$350.
5. Wrote off a debtors account \$280.
6. Owner withdrew cash for own use \$100.

### Required:

- a) Show the effect of the above transactions on the Basic Accounting Equation.

### Solution

	Asset	=	Liabilities	+	Capital
1.	+5000	=		+	<b>+5000</b>
2.	-600	=		+	<b>-600</b>
3.	+1000	=	+1000	+	
4.	+350	=		+	<b>+350</b>
5.	-280	=		+	<b>-280</b>
6.	<b>-100</b>	=		+	<b>-100</b>

### Example 2

Marian was in drapery business with the following assets and liabilities

Bank \$1500, Debtors \$4000, Stock \$3000, Motor Vehicle \$10000, Creditors \$3200 and Capital \$15300

**Show the effect of the following transactions on the accounting equation using perpetual method**

1. Sold stock to Seema on credit for \$500 ,cost price \$450.
2. Owner withdrew goods for own use \$150
3. Sold goods for cash \$1200( Cost Price \$1000).
4. Charged interest to debtors on overdue account \$55.
5. Seema paid her account in full less 10% discount.
6. Purchased Motor Vehicle for \$11000 from Motor World Ltd and made a down payment of \$3000.
7. Received commission \$500.
8. Theft of stock \$320.
9. Paid wages \$490.



**NB: under perpetual Inventory system – stock is affected each time sale /purchase transaction takes place.**

**Under physical inventory method – purchase of stock is treated as an expense.**

	Bank +	Debtors +	Stock +	Motor Vehicle	=	Creditors +	Capital
	1500 +	4000 +	3000 +	10000	=	3200 +	15300
1		+500	- 450		=		+50
2			-150		=		-150
3	+ 1200		-1000		=		+200
4		+55			=		+55
5	+450	-500			=		-50
6	-3000			+11000	=	+8000	
7	+500				=		+500
8			-320		=		-320
9	-490				=		-490
	160	4055	1080	21000	=	11200	15095



### Activity 3.2.1

1. Sashi Motors is running a business dealing with Chinese second hand vehicles and parts. The opening balances for the assets and liabilities are as follows:

<b>Cash at Bank \$50000</b>	<b>Vehicles (Stock) \$35000</b>	<b>Fixed Assets \$9000</b>
<b>Accounts Payable \$14000</b>	<b>Accounts Receivables \$3400</b>	<b>Capital?</b>

The following transactions took place during the month of June 2014:

- June 3      Sold a car for cash, \$15000 (cost price \$14500).
- 6      Bought a new computer for office use on credit from Shitals Computer \$3800.
- 8      Sold vans to Eveready Fashion for \$24 000,(cost price \$20 000). Eveready Fashion paid a deposit of \$5000 and the balance to be paid in three years' time.
- 18      Bought five cars from China at \$10 000 each for cash.
- 22      Repaired three tyres at \$45 each for cash.
- 28      Charged interest to Sharon on overdue accounts \$340.
- 29      The owner took \$500 from the business for her own use.
- 30      Paid telephone bill \$100.

#### **Required:**

- (i)      Calculate the opening Balance for the capital.
- ii)      Show the effects of the above transactions on the Accounting Equation.

**Note: Use Perpetual method**

2. Ashwin operates a grocery shop in Tavueni. Given below is the financial position of his business.

**Debtors \$12750, Inventory \$23000, Fixed Assets \$42000, Creditors \$19350, Bank Overdraft \$16500 Loan \$10000 Capital?**

The following transactions took place during the month.

May1 Bought goods on credit from Samu \$1200.

4 Sold furniture (cost price \$3500) for cash \$4800.

7 Paid Loan \$4500.

10 Owner took cash for own use \$300.

14 Bought Motor vehicle for \$8000 and made a down payment of \$3500.

18 Sold groceries on credit to Anita \$750.

20 Paid Khan \$1000 and discount received \$200.

23 Received rent \$600.

25 Anita paid \$600 less 15% discount.

28 Paid electricity bill \$180.

29 Charged interest on debtor's overdue account \$65.

**Required:**

i) Calculate the opening capital.

ii) Show the effect of the above transactions on the Accounting Equation. Use Physical Inventory Method.

3. Lina operates a surgery under the name LD Medical Centre in Lautoka. The balances of the accounts were as follows:

**Cash \$8000, Debtors \$3600, Stock- Medicine \$2000, Furniture \$700, Creditors \$1200 and Capital \$13100**

The following transactions occurred during April

1. Purchased medicine on account \$800.
2. The owner took furniture for personal use \$150.
3. Billed customers for services rendered \$2500.
4. Insurance premium of \$80 expired for the month.
5. Sold furniture original cost \$190 for \$120 cash.
6. Paid internet bills \$72.
7. Received a cheque from debtors \$540.
8. Paid creditors \$700 and received \$25 discount.
9. A debtors cheque of \$540 dishonoured.
10. Lina invested her personal furniture into the business \$250.
11. A debtor who owes \$200 agreed to pay \$0.75 in every dollar.

**Required:**

- a) Prepare the Accounting Equation of LD Medical Centre showing the effects of the above transactions.

4. Alvin operates a laundry business in Nausori. He started the business with the following asset and liabilities:

**Stock \$900, Equipment \$17800, Expense \$500 Bank Overdraft \$6500 and Creditors \$2600, Revenue \$2500**

His transactions for the month of April are as follows:

1. Received \$360 for services performed for cash customers.
2. Paid salaries \$290.
3. Raised loan on mortgage \$2000.
4. Received rent from a tenant \$278.
5. Paid creditors \$1500 and received discount \$75.
6. Paid freight for transportation of parcel by Sofi boat \$17.
7. Bought equipment on account for \$600 less 2% trade discount.
8. Stock stolen from the business valued \$64.
9. The owner invested \$780 into the business.
10. Interest owing on overdue account to a creditor \$48.
11. The owner withdrew \$80 for personal use.
12. Repayment of mortgage amounted to \$400.

**Required:**

- a) Record the above transactions and balance after each transaction using the equation: **Stock + Equipment + Expenses = Bank Overdraft + Creditors + Mortgage + Capital + Revenue.**

**Writing down Possible transactions from the Extended Accounting Equation**

5. Ashika operates a restaurant at Tappoo City. The following transactions relates to Ashika's business.

	<b>Stock +</b>	<b>Debtors +</b>	<b>Fitting +</b>	<b>= Bank</b>	<b>+ Creditors</b>	<b>+Capital</b>
	\$2400	\$600	\$7000	\$2000	\$1000	\$7000
a				-300		+300
b		-60		-50		-10
c				+460	-500	+40
d			-2000	-1800		-200
e	+500			+500		
f		+30				+30
g		+2300	- 2500			-200
h	+100				+100	

**Required:** Write possible transactions for a – h.

6.

Rakesh operates Lal's Store in Savusavu. Given below is the financial position as at 1 March 2014

	<b>Stock + \$25000</b>	<b>Debtors + \$10250</b>	<b>Fixed Assets + \$45000</b>	<b>= Bank \$25500</b>	<b>+ Creditors \$8500</b>	<b>+ Capital 46250</b>
Mar 1	-7863			- 9250		+1387
10	+ 5150			+5150		
13	-1296	+1525				+229
18			-3660	-5200		+1540
20					+230	-230
28			+10000	+10000		
	<b>20991</b>	<b>11775</b>	<b>51340</b>	<b>26200</b>	<b>8730</b>	<b>49176</b>

**Required:** Write possible transactions for the Mar (1 - 28)

### 3.3 ANALYSIS CHART

#### Double Entry Rule

➡ Each transaction affects two accounts ➡ Debit and Credit

#### Showing the effect of transactions in the Analysis Chart.

**Example:** The following transactions relate to the business of Rakesh.

Dec 5 Rakesh commenced a canteen business with \$6000.

- 10. Purchased goods for cash \$300.
- 12. Sold furniture on credit to John \$1000.
- 15. Sold goods for cash \$350.
- 18. wrote off a debtor (Semi's) account \$280.
- 19. Owner withdrew cash for own use \$100.
- 22. Received loan from Luisa \$600.
- 24. Paid Ana \$200 less 10% discount.
- 27. Sold goods on credit to Peter \$120.
- 29. Received Commission \$256.
- 31. Paid insurance premium \$430.

## Solution

Date	Accounts Affected	Elements (A,E,L,P,R)	Entry Dr/Cr	Amounts \$
Dec 5	Cash	A	Dr	6000
	Capital	P	Cr	6000
10	Purchases	E	Dr	300
	Cash	A	Cr	300
12	Debtor – John	A	Dr	1000
	Furniture	A	Cr	1000
15	Cash	A	Dr	350
	Sales	R	Cr	350
18	Bad debts	E	Dr	280
	Semi	A	Cr	280
19	Drawings	P	Dr	100
	Cash	A	Cr	100
22	Cash	A	Dr	600
	Loan - Luisa	L	Cr	600
24	Ana	L	Dr	200
	Cash	A	Cr	180
	Disc received	R	Cr	20
27	Peter	A	Dr	120
	Sales	R	Cr	120
29	Cash	A	Dr	256
	Commission	R	Cr	256
31	Insurance premium	E	Dr	430
	Cash	A	Cr	430



### Activity 3.3.1

#### Multiple Choice

1. The two accounts affected when the owner takes goods home for own use are

- A. drawing Dr and purchase Cr
- B. drawings Dr and cash Cr
- C. cash Dr and Drawing Cr
- D. drawing Dr and stock Cr

2. The owners' equity in the business is

- A. assets of the business
- B. liabilities of the business
- C. expense of the business
- D. proprietorship of the business

3. The following transactions are of Laisa's Law firm for the month of January.

Jan 1 The owner invested \$30000 in the business.

3 Paid wages for the month \$600.

5 Received commission from the supplier \$480.

10 Bought gift for his mother \$50.

12 Bought a Delivery vehicle for cash \$12000.

15 Earned fees from law practice \$8000.

18 Purchased Furniture on credit from Litia \$900.

22 Received a cheque from a debtor Krishna \$500.

25 Received an invoice from Suhani for doing repair works \$40.

28 Sold office furniture on credit purchase price \$900 for \$120.

#### **Required:**

Show the effect of the following transactions in the Analysis chart.

4. Given below is a series of transactions for Akanisi who operates the Labasa resort

- a) Invested additional capital in the business \$2000.
- b) Received an invoice for repairing a building \$200.
- c) Received payment for tourist's breakfast \$120.
- d) Paid wages to Maikeli \$60.
- e) Sent a cheque to FDB for monthly repayment of loan \$850.
- f) Received from a debtor Jone \$200 less 5% discount.
- g) Bought double bunker beds for \$1400 from Ali making a down payment of \$600.



- h) Sold old furniture cost price \$250 for \$350 to Rashi on credit.
- i) Gave a donation of \$300 to Labasa Old Society.
- j) Received interest on investment \$450.

**Required:** Show the effect of the following transactions in the Analysis chart

5. M.Sami operates a Save & Shop in Wailevu. The following are the transactions for the month of October in his business.

Oct 3 Sold goods for cash \$40.

7 Received an invoice from Consort shipping for freight \$20.

10 Received an amount of \$60 from Albert which was previously written off \$26.

18 M.Sami took goods for his wife's birthday cost price \$40, selling price \$80.

21 Received an invoice from David \$125.

23 Mere returned goods which was previously sold to her \$21.

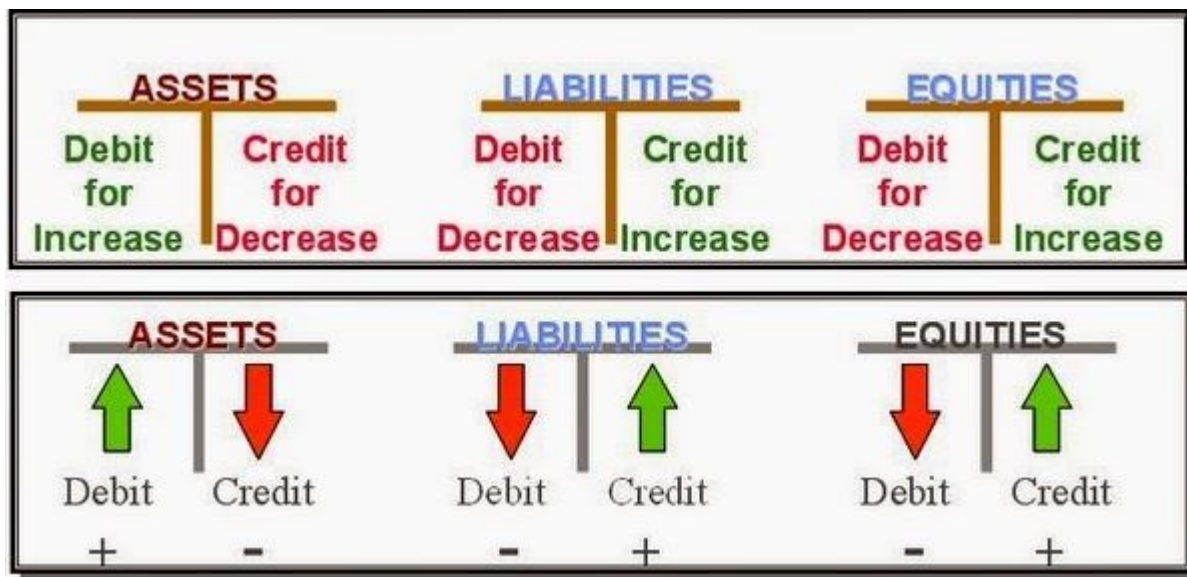
27 Paid telephone bill \$60.

**Required:** Show the effect of the following transactions in the Analysis chart. Business uses Physical Inventory method.

### 3.4 LEDGERS AND TRIAL BALANCE

#### What is a Ledger?

A book in which monetary transactions of the business is posted in the form of debits and credits.



Source : [www.google.com](http://www.google.com)

## T Form Ledger Accounts

Is a ledger account that is represented by a debit and credit entries.

### Debit Entry

- ➡ Debit Entry is made on the left hand side of the 'T' Account.

#### Ledger Account

Date	Particulars	Amount	Date	Particulars	Amount

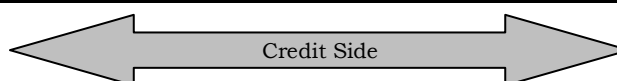


### Credit Entry

- ➡ Credit Entry is made on the right hand side of the 'T' Account.

#### Ledger Account

Date	Particulars	Amount	Date	Particulars	Amount



### Example:

On Jan 1 2015, Sera's book showed the following assets: cash at bank \$5000, Stock \$2600, Debtors: J.Prasad \$450, Poi Lee \$600 and Office Furniture \$7700. His liabilities were Sovalevu \$2600 and Nilam \$290.

Her transactions for the month were:

Date	Transactions
Jan 2	Sold goods for cash \$200.
4	Sold goods to J.Prasad \$90 less 10% trade discount.
5	Paid wages \$115.
7	Purchased goods from TV Ltd for \$300 cash.
8	Issued credit note to J. Prasad for damaged goods \$25.
19	Bought goods from Nilam for \$75 on account.
	Paid freight \$7 on goods bought on June 7.
20	Sold goods to J. Prasad \$380.
22	Received invoice from Comfort Ltd for repairing furniture \$86.
	Cash sales \$354.
28	Received \$260 from Poi Lee and discount allowed \$10.

**Required:**

i. Post the above transactions into relevant ledger accounts using T form.

**Ledger Account****Cash at Bank**

<i>Date</i>	<i>Particulars</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>Amount</i>
<b>Jan 1</b>	Balance	5000	Jan 5	Wages	115
<b>2</b>	Sales	200	7	Purchases	300
<b>22</b>	Sales	354	19	Freight	7
<b>28</b>	Poi Lee	260	31	Balance c/d	5392
		<b><u>5814</u></b>			<b><u>5814</u></b>
<b>Feb 1</b>	Balance B/f	5392			

**Stock**

<i>Date</i>	<i>Particulars</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>Amount</i>
<b>Jan 1</b>	Balance	2600			

**J. Prasad**

<i>Date</i>	<i>Particulars</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>Amount</i>
<b>Jan 1</b>	Balance	450	Jan 8	Sales Returns	\$25
<b>4</b>	Sales	81	31	Balance c/d	886
<b>20</b>	Sales	380			
		<b><u>911</u></b>			<b><u>911</u></b>
<b>Feb 1</b>	Balance b/f	886			

**Poi Lee**

<i>Date</i>	<i>Particulars</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>Amount</i>
<b>Jan 1</b>	Balance	\$600	Jan 28	Cash & Disc	\$270
			31	Balance	330
		\$600			\$600
<b>Feb 1</b>	Balance B/f	330			

### Office Furniture

<i>Date</i>	<i>Particulars</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>Amount</i>
<b>Jan 1</b>	Balance	7700			

### Sovalevu

<i>Date</i>	<i>Particulars</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>Amount</i>
			Jan 1	Balance	2600

### Nilam

<i>Date</i>	<i>Particulars</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>Amount</i>
<b>Jan 31</b>	Balance c/d	365	Jan 1	Balance	290
			19	Purchases	75
		365			365
			Feb 1	Balance b/f	365

### Sales

<i>Date</i>	<i>Particulars</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>Amount</i>
<b>Jan 31</b>	Balance	1015	Jan 1	Cash	200
			4	J.Prasad	81
			20	J.Prasad	380
			22	Cash	354
		<b><u>1015</u></b>			<b><u>1015</u></b>
			Feb 1	Balance b/f	1015

### Wages

<i>Date</i>	<i>Particulars</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>Amount</i>
<b>Jan 5</b>	Cash	115			

### Comfort Ltd

<i>Date</i>	<i>Particulars</i>	<i>Amount</i>	<i>Date</i>	<i>Particulars</i>	<i>Amount</i>
			Jan 22	Repairs	86

### **Sales Return**

<b>Date</b>	<b>Particulars</b>	<b>Amount</b>	<b>Date</b>	<b>Particulars</b>	<b>Amount</b>
<b>Jan 1</b>	J.Prasad	25			

### **Purchases**

<b>Date</b>	<b>Particulars</b>	<b>Amount</b>	<b>Date</b>	<b>Particulars</b>	<b>Amount</b>
<b>Jan 7</b>	Cash	300	Jan 31	Balance c/d	375
<b>19</b>	Nilam	75			
		<b>375</b>			<b>375</b>
<b>Feb 1</b>	Balance b/f	375			

### **Freight**

<b>Date</b>	<b>Particulars</b>	<b>Amount</b>	<b>Date</b>	<b>Particulars</b>	<b>Amount</b>
<b>Jan 19</b>	Cash	7			

### **Repairs**

<b>Date</b>	<b>Particulars</b>	<b>Amount</b>	<b>Date</b>	<b>Particulars</b>	<b>Amount</b>
<b>Jan 22</b>	Comfort Ltd	86			

### **Capital**

<b>Date</b>	<b>Particulars</b>	<b>Amount</b>	<b>Date</b>	<b>Particulars</b>	<b>Amount</b>
			Jan 1	Balance	13460

### **Discount Allowed**

<b>Date</b>	<b>Particulars</b>	<b>Amount</b>	<b>Date</b>	<b>Particulars</b>	<b>Amount</b>
<b>Jan 28</b>	Poi Lee	10			

### **Three – Column Ledger Account**

- This ledger account has three columns namely Debit, Credit and Balance.

#### **Advantages**

- It helps to calculate balance after each transaction
- Avoids monthly ruling of accounts which is usually done in Two Column ledger
- is suitable for computer or machine accounting where progressive balance is worked out automatically after posting each transaction

### Illustration of Three Column Ledger

<i>Date</i>	<i>Particulars</i>	<i>Debit</i>	<i>Credit</i>	<i>Balance</i>

#### Example of 3 –Column Ledger:

##### Cash at Bank

<i>Date</i>	<i>Particulars</i>	<i>Debit</i>	<i>Credit</i>	<i>Balance</i>
		\$	\$	\$
Jan1	Balance			5000 DR
2	Sales	200		5200 DR
5	Wages		115	5085 DR
7	Purchases		300	4785 DR
19	Freight		7	4778 DR
22	Sales	354		5132 DR
28	Poi Lee	260		<b>5392</b> DR

### Trial Balance

- ➡ **A trial balance** is a list of all the General ledger accounts (both revenue and capital) contained in the ledger of a business. The value of the ledger will hold either a **debit** balance value or a **credit** balance value.
- ➡ The profit and loss statement and balance sheet and other financial reports can then be produced using the ledger accounts listed on the trial balance.
- ➡ An example of a trial balance in 'T' form is shown below:

#### Trial Balance of X Supermarket as at 31<sup>st</sup> December 2014

<b>Elements of A, E, D</b>	<b>\$</b>	<b>Elements of L,P, R</b>	<b>\$</b>
Cash at Bank	XX	Accounts Payable	XX
Furniture	XX	Loan	XX
Purchases	XX	Commission	XX
Insurance	XX	Discount Received	XX
Debtor – P. Chand	XX	Subs due	XX
Loss on Sale	XX	Mortgage	XX
Drawings	XX		
	<b>\$XX</b>		<b>\$XX</b>

### Three Column Trial Balance

#### Trial Balance of X Supermarket as at 31<sup>st</sup> December 2014

	\$	\$
Cash at Bank	XX	
Furniture	XX	
Purchases	XX	
Insurance	XX	
Debtor – P. Chand	XX	
Loss on Sale	XX	
Drawings	XX	
Accounts Payable		XX
Loan		XX
Commission		XX
Discount Received		XX
Subs due		XX
Mortgage		XX
	<b>\$XX</b>	<b>\$XX</b>

### ***Solution of the above Example***

Trial Balance of Sera as at 31 <sup>st</sup> January 2015			
	\$		\$
Cash	5392	Nilam	365
Stock	2600	Sales	1015
J.Prasad	886	Comfort Ltd	86
Poi Lee	330	Capital	13460
Office Furniture	7700	Sovalevu	2600
Freight	7		
Discount Allowed	10		
Wages	115		
Purchases	375		
Sales Returns	25		
Repairs	86		
	<b><u>17526</u></b>		<b><u>17526</u></b>





## Activity 3.4.1

### Accounting Procedures

1. Sarojini owns a Car sales Business. The transaction for his business for the month of September is recorded in the Analysis Chart below.

Date	Accounts Affected	Elements (A,E,L,P,R)	Increase (+) Decrease (-)	Entry Dr/Cr	Amounts \$
Sept 1	Mere	A	+	Dr	11000
	Sales	R	+	Cr	11000
5	Drawings	P	-	Dr	6000
	Car	A	-	Cr	6000
11	Computer	A	+	Dr	3000
	Cash	A	-	Cr	1000
	Bondwell	L	+	Cr	2000
15	Drawings	P	-	Dr	100
	Cash	A	-	Cr	100
21	Cars	A	+	Dr	50000
	Atoz Ltd	L	+	Cr	50000
24	Cash	A	+	Dr	5000
	Discount allowed	E	+	Dr	500
	Mere	A	-	Cr	5500
27	Cash	A	+	Dr	10000
	Loan- ANZ	L	+	Cr	10000
30	Interest Payable	E	+	Dr	200
	ANZ	L	+	Cr	200

### Required:

Prepare the relevant ledger accounts using T Form from the data given in the analysis chart.

2. Masi owns a watch shop in Nadi. In the Analysis chart given below, each date records the effect of transactions for the month of May.

Date	Accounts Affected	Elements (A,E,L,P,R)	Entry Dr/Cr	Amounts \$
May 4	Purchases	E	Debit	1000
	Orisi & Co	L	Credit	1000
7	Irshad Gani	A	Debit	200
	Sales	R	Credit	200
11	Cash	A	Debit	50
	Commission	R	Credit	50
14	Drawings	P	Debit	100
	Purchases	E	Credit	100
16	Cash at bank	A	Debit	7000
	Loss on sale	E	Debit	3000
	Motor vehicle	A	Credit	10000
19	Furniture	A	Debit	800
	Cash at bank	A	Credit	200
	Dass & Co.	L	Credit	600
24	Orisi & Co	L	Debit	1000
	Cash at bank	A	Credit	950
	Discount received	R	Credit	50
27	Cash at bank	A	Debit	150
	Bad debts	E	Debit	50
	Irshad Gani	A	Credit	200
29	Advertising	E	Debit	150
	Cash at bank	A	Credit	150
30	Delivery van	A	Debit	2880
	Capital	P	Credit	2880

**Required:** Prepare relevant ledger accounts using 3 column form from the above analysis.

3.

From the following information of Telei's business, **prepare the appropriate ledger Accounts and take out a trial balance.** The owner commenced business with the following assets and liabilities at 1 April 2014.

	\$	\$
Cash in hand	100	
Cash at bank	400	
Accounts receivable: T. Blake	50	
L.Gibson	110	
Inventories	900	
Vehicle	3000	
Equipment	5000	
Building	11000	
Land	11000	
Accounts payable: B Racey		500
G Hall		100
Loan from bank		2000

<b>Date</b>	<b>Particulars</b>
April 2	Sold goods to T Blake for cash \$200
	Purchased goods from B Racey \$300
	Paid \$500 off the loan
	Cash sales \$100
3	Owner withdrew goods \$40
4	Sold vehicle for \$3000 cash
	Purchased goods from G Hall \$200
	Cash sales \$150
5	Received \$45 cash from T Blake in full of the account on 1 April

6	Paid B Racey \$200 and received \$40 discount Sold goods to L Gibson \$100
7	Purchased inventories from G Wall \$100
8	Returned goods to the value \$50 to G Wall
10	Cash sales \$1000 Paid interest on loan \$50
17	L Gibson returned inventories to the value of \$10
19	Cash sales \$80
20	Received \$100 from L Gibson Bought for equipment for \$3000 from ABC Ltd
23	Sold inventories to T Blake \$60
25	Purchased inventories for cash \$100
26	Paid Stationery \$50, Postage and Stamps \$45

### Errors not revealed by the Trial Balance

- ➡ Even if the trial balance is balanced, it may be subject to errors. Some types of errors which are not disclosed by the trial balance is listed below:

#### Error of Principle

- ✚ is the posting to the correct side of the ledger but to the wrong account.
- ✚ It affects the capital expenditure and the revenue expenditure.
- ✚ An example would be the purchase of a motor vehicle wrongly recorded in the motor vehicle expense account.

#### Error of Commission

- ✚ is the posting of the correct amount but to the wrong account.
- ✚ An example would be the cash received from a customer, posted in error to another person's account.

#### Error of Omission

- ✚ is when a transaction is completely not recorded or has been omitted.

#### Compensating Error

- ✚ is where one wrong entry is offset by the other.
- ✚ It cancels out the effect of a second mistake.



### Activity 3.4.2

#### **Multiple Choice and Interpretations**

1. Buying of Vehicle for \$3000 had been recorded in Vehicle repairs account by the accounts clerk. This error is known as:

- A. Compensating error
- B. Omission error
- C. Error of principle
- D. Error of Commission.

2. State the type of error made in each of the following cases :

- a) Bank charges \$10, had been debited to the Electricity account.
- b) Entries for Goods returned by the debtor had been omitted \$80.
- c) A cheque send by a debtor for \$450 had been recorded as \$540.
- d) Wages \$90, paid for installing a new plant, had been debited to the salaries account.
- e) The total of the Sales journal was posted to the ledger as \$2250, instead of \$512.
- f) The purchase of a computer, at a cost of \$5270, had been posted to the purchases account.
- g) An amount of \$600 received for commission had been wrongly entered in the cash book as received for interest.

# MEASURING PERIODIC INCOME - 1



## Strand Outcome

Apply Accounting principles and processes to financial transaction from preparation of fully classified Statement of Financial performance and Statement of Financial Position From given Trial Balance, accounting for all the balance day adjustments.

## Learning Outcomes

- Examine balance day adjustments and account for them in the financial records of the business.
- Prepare fully classified Statement of Financial Performance and Position from Trial balance and Worksheets with adjustments.

STRAND

4

## 4.1 Balance Day Adjustments

- ➡ Balance day adjustments are adjustments that need to be made on some accounts at the end of the financial year, so that they accurately reflect the performance of the business.
- ➡ These are only required when a company is using an accrual accounting system, as income or expenses may be recognized and paid or received at different times.

### Purpose of Balance Day Adjustments

- is to match costs against related income and also to up – date the accounts at the end of the financial period.

### + Cash Basis Accounting

- means that revenues and expenses are not recognized until the cash is received or paid.

### + Accrual Basis Accounting

- means that revenue is recognized when earned and expenses when incurred, irrespective of whether they are cash or credit transaction.
- it takes into account all the revenues and expenses during the period to measure profit and loss .
- Accrual basis is better than cash basis because revenue is matched against expenses incurred in earning them.

### 1. Prepayments

- ➡ They represent expenses which are paid during the year but relates to next accounting period.
- ➡ They are also termed as Unexpired Cost, Expenses paid in advance or Prepaid Expenses.

### Rules for Posting

Date	Particulars	Debit \$	Credit \$
	Prepaid Expense	xx	
	Related Expense Account		xx

- Deduct the amount of prepayment from the related expense figure on the **debit side** of profit and loss account/Statement of Financial Performance.
- Record the amount of prepayment under **current assets** in the balance sheet.

### E.g 1

### Trial Balance(Extract)

	\$		\$
Insurance	550		



## Additional Information

1. Insurance paid in advance/ unexpired \$100.

### Solution:

#### General Journal Entry

Date	Particulars	Debit \$	Credit \$
	Insurance Prepaid	100	
	Insurance		100
	(To record insurance prepaid)		

#### Profit and Loss (extract)

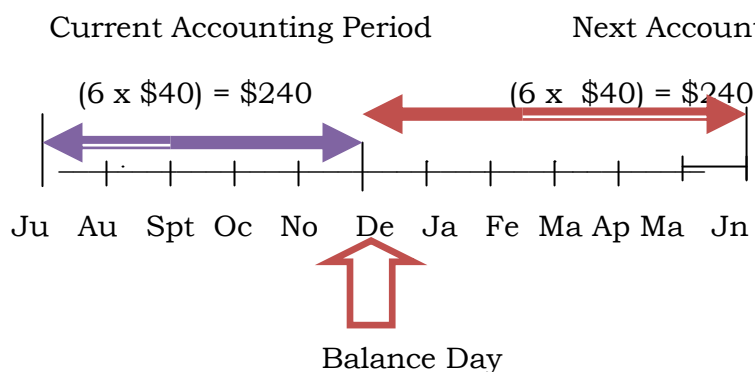
	\$		\$
Insurance (550- 100)	450		

#### Balance Sheet (extract)

	\$		\$
<b>Current Assets</b>			
Insurance prepaid	100		

### E.g. 2.

Assume that on 1<sup>st</sup> July, 2014 \$480 was paid for a full year of rates. The balance day falls on 31<sup>st</sup> December.



### Solution:      General Journal Entry

Date	Particulars	Debit \$	Credit \$
	Rates Prepaid	240	
	Rates		240

### Profit and Loss (extract)

	\$		\$
Rates (480- 240)	240		

### Balance Sheet (extract)

	\$		\$
<b>Current Assets</b>			
Rates Prepaid	240		

## **2. Accrued Expenses**

- ➡ Are expenses which has been incurred but not yet paid.
- ➡ Also known as expenses due, unpaid expense, expired cost.

### Rules for Posting

Date	Particulars	Debit	Credit
	Related Expense Account	xx	
	Expense Due		xx

- Add the unpaid amount to the related expense figure on the **debit** side of profit and loss account.
- Record the amount of expense due under **current liabilities** in the balance sheet.

### **E.g 1**

### **Trial Balance**

	\$		\$
Interest	325		

### **Additional Information**

1. Interest unpaid on balance day amounted to \$75

**Solution:****General Journal Entry**

Date	Particulars	Debit \$	Credit \$
	Interest	75	
	Interest due		75
	(To record interest due but not paid)		

**Profit and Loss (extract)**

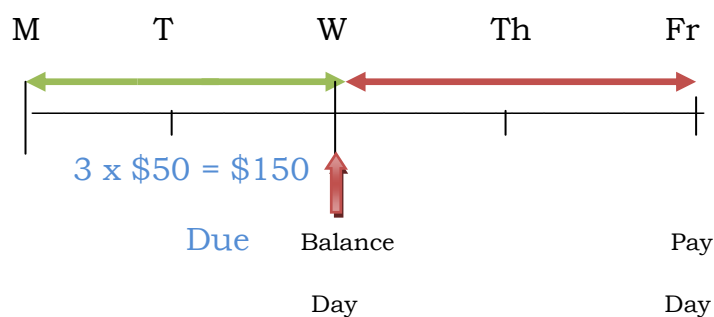
	\$		\$
Interest (325 + 75)	400		

**Balance Sheet (extract)**

	\$		\$
		<b>Current Liability</b>	
		Interest due	75

**E.g. 2**

Assume Priya's Beauty pays a weekly wages of \$250 to her sales boy each Friday. The balance day for Priya's Beauty falls on Wednesday 31<sup>st</sup> March.

**Solution : General Journal Entry**

Date	Particulars	Debit \$	Credit \$
	Wages	150	
	Wages due		150
	(To record wages due but not paid)		

### Profit and Loss (extract)

	\$		\$
Wages	150		

### Balance Sheet (extract)

	\$		\$
		<b>Current Liability</b>	
		Wages due	150

### **3. Income Accrued**

- ➡ It is the income that is earned during the accounting period but not received on balance day.
- ➡ It is also known as income in arrears, income due, income receivable, etc.

### Rules for Posting

Date	Particulars	Debit \$	Credit \$
	Income Due	xx	
	Related Income Account		xx

- **Add** the amount to the income due to the related income account on the credit side of profit and loss account.
- Record the amount of income due under **current assets** in the balance sheet.
- 

**E.g 1**

### Trial Balance

	\$		\$
		Interest on Deposit	300

### **Additional Information**

1. Interest on deposit due on balance day \$30

### Solution: General Journal Entry

Date	Particulars	Debit \$	Credit \$
	Interest on deposit due	30	
	Interest on deposit		30
	(To record interest due but not received)		

### Profit and Loss (extract)

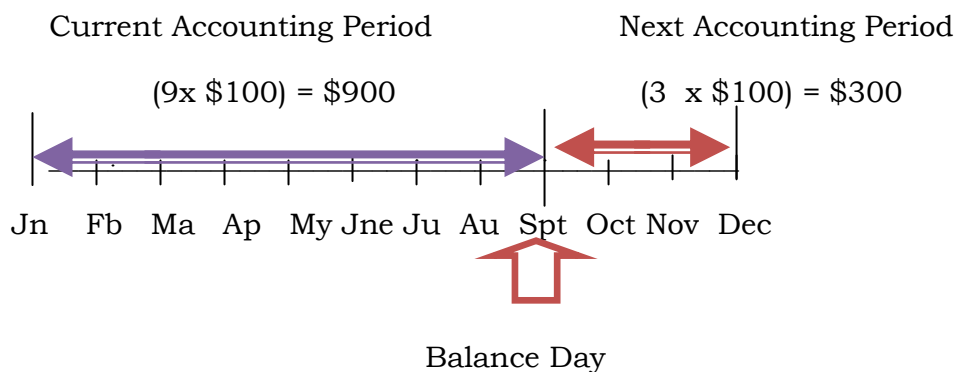
	\$		\$
		Interest on deposit (300 + 30)	330

### Balance Sheet (extract)

	\$		\$
<b>Current Asset</b>			
Interest on deposit due	30		

#### **E.g. 2**

Assume dividend is received at the end of the year on 31<sup>st</sup> December and the amount is estimated to be \$1200. The balance date falls on 30<sup>th</sup> September.



### Solution : General Journal Entry

Date	Particulars	Debit \$	Credit \$
	Dividend due	900	
	Dividend		900
	(To record dividend due)		

### Profit and Loss (extract)

	\$		\$
		Dividend (1200 - 300)	900

### Balance Sheet (extract)

	\$		\$
<b>Current Asset</b>			
Dividend due	900		

#### 4. Revenue received in advance

- ➡ This represents the income that is not earned but received in advance on the balance day.
- ➡ It is also known as income in advance, unearned revenue or pre-received revenue.

#### Rules for Posting

Date	Particulars	Debit \$	Credit \$
	Related Income Account	xx	
	Income Received in Advance		xx

- Deduct the amount of the income received in advance from the related income account on the **credit** side of profit and loss account.
- Record the amount of income received in advance under **current liabilities** in the balance sheet.

E.g 1

#### Trial Balance

	\$		\$
		Commission	600

#### Additional Information

1. Commission received in advance \$200

#### Solution: General Journal Entry

Date	Particulars	Debit \$	Credit \$
	Commission	200	
	Commission Received in advance		200

#### Profit and Loss (extract)

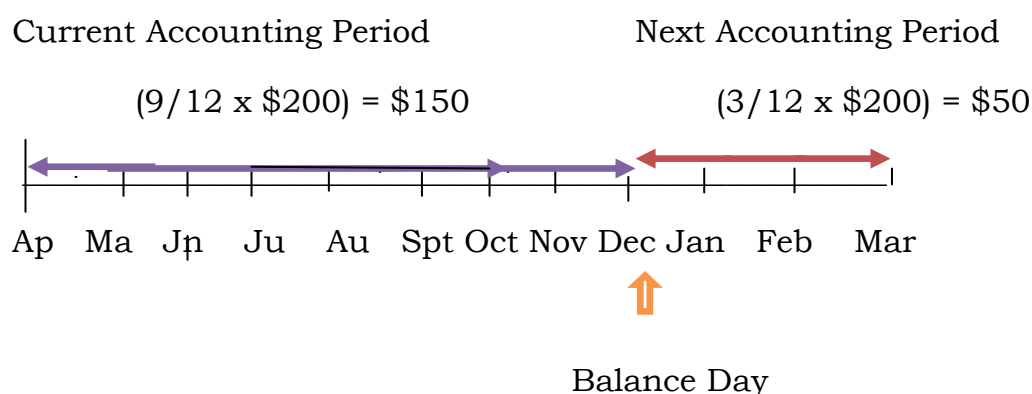
	\$		\$
		Commission (600 - 200)	400

#### Balance Sheet (extract)

	\$		\$
		<b>Current Liability</b>	
		Commission received in advance	200

**E.g. 2**

Received rent on April 1<sup>st</sup> 2014, \$200 which is for **one year**. The balance day falls on 31<sup>st</sup> December.

**Solution: General Journal Entry**

Date	Particulars	Debit \$	Credit \$
	Rent	50	
	Rent received in advance		50

**Profit and Loss (extract)**

	\$		\$
		Rent (200- 50)	150

**Balance Sheet (extract)**

	\$		\$
		<b>Current Liability</b>	
		Rent received in advance	50

**Activity 4.1.1****A. Multiple Choice**

- The purpose of balance day adjustment is:
  - To detect fraud
  - To analyze transactions
  - To match revenue with assets
  - To match revenue with costs to derive accurate profits



2. Which of the following is not an asset?
  - A. Cash
  - B. Inventory
  - C. Expenses due
  - D. Prepayments
3. Explain the meaning of the following terms:
  - Accrual basis
  - Unexpired cost
  - Unearned revenue

**Accounting Procedure:**

**4. Trial balance of Charlie Enterprise (extract) as at 30<sup>th</sup> June 2013**

	\$		\$
Insurance	1230	Rent	1100
Vehicles	8100	Interest on Investment	2500
Wages	190		

**Balance day Adjustments**

1. Wages due \$48
2. Insurance prepaid \$87
3. Rent accrued \$158
4. Interest on investment received in advance \$500

**Required:**

- a) Prepare the General Journal entries for the above.
- b) Prepare the Profit and loss extract.
- c) Prepare the balance sheet extract.

## **Depreciation**

✚ refers to the writing off the cost of a fixed asset over its useful life .

### **Straight Line Method/ Fixed Installment Method**

- The depreciation expense remains the same irrespective of the year.
- The book value of the asset decreases at a constant amount.

#### **Formula**

$$\begin{array}{l} \text{Depreciation per} = \frac{\text{Original cost} - \text{Scrap value}}{\text{Annum/ Year} \quad \quad \quad \text{Estimated useful life}} \\ \text{OR} \\ \text{Depreciation per Annum/ Year} = \text{Original Cost} \times \text{Rate} \end{array}$$

#### **Example**

On 1 January 2011 a business purchased Equipment for \$6000 cash. Its estimated life was considered to be 5 years with a residual value of \$2000. The financial year ends on 31 December each year.

#### **Required:**

a) Calculate Depreciation per annum for equipment

$$\text{Depreciation per annum} = \frac{\text{Original Cost} - \text{Scrap value}}{\text{Estimated Useful Life}}$$

$$\begin{array}{l} \$800/ \text{ annum} \quad = \quad \frac{\$6000 - \$2000}{5 \text{ Years}} \end{array}$$

#### **► General Journal Entry for Recording Depreciation**

Date	Particulars	Debit \$	Credit \$
	Depreciation on (name of the asset)	800	
	Provision for depreciation (name of the asset)		800

### **Balance Sheet (extract)(31/12/13)**

<b><u>Fixed Asset</u></b>	\$
Name of the Asset (Original Cost)	6000
Less Accumulated Depreciation	<u>2400</u>
Book value	<u>3600</u>

### **Another name for Provision for Depreciation is Accumulated Depreciation**

**Provision for Depreciation** means the total amount of depreciation that has accumulated for a particular asset

#### **Bad Debts**

- ➡ A **bad debt** is the loss arising from the debtor that is unlikely to pay his/her debt.
- ➡ Bad Debt arises when:
  - The debtor has gone bankrupt
  - The debtor has migrated
  - It is too costly to take legal action to collect a small amount of debt

#### **Rules for Posting**

<b>Date</b>	<b>Particulars</b>	<b>Debit \$</b>	<b>Credit \$</b>
	Bad Debts	xx	
	Debtors		xx

- The amount of bad debts from the adjustment is added to the related bad debts expense on the debit side of the profit and loss account
- The debtor is decreased by the amount of bad debts from the adjustment in the balance sheet under current assets

#### **Example**

#### **Trial Balance**

	\$		\$
Debtors	\$1600		
Bad Debts	340		

#### **Additional Information**

1. Provide bad debts on debtors at 10%

#### **Solution:**

### General Journal Entry

Date	Particulars	Debit \$	Credit \$
	Bad Debts (10/100 x 1600) Debtors ( To record bad debts written off)	160	160

### Profit and Loss (extract)

	\$		\$
Bad Debts (340 + 160)	500		

### Balance Sheet (extract)

	\$		\$
<b>Current Asset</b>			
Debtors (1600 – 160)	1440		

### Doubtful Debts

- ➡ Doubtful debts are those debts which a business or individual is unlikely to be able to collect.
- ➡ The reasons for potential non-payment can include disputes over supply, delivery, and the condition of item or the financial stress within a customer's operations. When such a dispute occurs it is prudent to add this debt to the doubtful debt account.

### Rules for Posting

#### **1. To Create Provision for Doubtful Debts**

Date	Particulars	Debit \$	Credit \$
	Doubtful Debts	xx	
	Provision for Doubtful Debts		xx

#### **2. To Increase Provision for Doubtful debts**

Date	Particulars	Debit \$	Credit \$
	Doubtful Debts	xx	
	Provision for Doubtful Debts		xx

### 3. To Decrease Provision for Doubtful debts

Date	Particulars	Debit \$	Credit \$
	Provision for Doubtful Debts	xx	
	Doubtful Debts		xx

#### Formula for Calculating

$$\text{Doubtful Debt} = (\text{Debtors} - \text{Additional Bad Debts}) \times \text{Rate} / 100$$

- Actual amount of provision for doubtful debts is calculated by using the above formula.

#### Rules to follow

Estimated amount for doubtful debts is given in the trial balance on the **credit side**

Actual amount > Estimated amount = increase in provision for doubtful debts

Actual amount < Estimated amount = decrease in provision for doubtful debts

Actual amount is deducted from the Debtors in the balance sheet under current assets

### 1. To Create Provision for Doubtful Debts

#### Example 1:

#### Trial Balance

	\$		\$
Debtors	\$7000		

#### Additional Information

1. The provision for doubtful debts to be 10% of debtors

**Formula for Calculating = ( Debtors – Additional Bad Debts) \* Rate**

**Provision for Doubtful Debts**

$$\text{\$700} = ( \text{\$7000} - 0 ) \times 10/100$$

**Solution:**

**General Journal Entry**

Date	Particulars	Debit \$	Credit \$
	Doubtful Debts	700	
	Provision for Doubtful Debts		700

**Profit and Loss (extract)**

	\$		\$
Doubtful Debts	700		

**Balance Sheet (extract)**

	\$		\$
<b>Current Assets</b>			
Debtors (7000 – 700)	6300		

**2. To Increase Provision for Doubtful Debts**

**Trial Balance**

	\$		\$
Debtors	\$12000	Provision for Doubtful Debts	300

**Additional Information**

1. Wrote off Bad debts \$1000

2. The provision for doubtful debts to be 5% of debtors

Formula for Calculating Provision for Doubtful Debts	=	( Debtors – Additional Bad Debts) * Rate
<b>\$550</b>	=	( <b>\$12000 - 1000</b> ) x <b>5/100</b>

**Solution:**

**General Journal Entry**

Date	Particulars	Debit \$	Credit \$
	Bad Debts	1000	
	Debtors		1000

Date	Particulars	Debit \$	Credit \$
	Doubtful Debts	250	
	Provision for Doubtful Debts		250

**Profit and Loss (extract)**

	\$		\$
Bad Debts	1000		
Doubtful Debts	250		

**Balance Sheet (extract)**

	\$		\$
<b>Current Assets</b>			
Debtors (12000 – 1000)	11000		
Less Provision for doubtful debts	<u>550</u>		
	<u>10450</u>		

**E.g. 2****Trial Balance (Extract)**

	\$		\$
Debtors	\$8600	Provision for Doubtful Debts	120

**Additional Information**

1. Wrote off Additional Bad debts \$600
2. The provision for doubtful debts to be 2% of debtors

Formula for Calculating	=	( Debtors – Additional Bad Debts) * Rate
Provision for Doubtful Debts		
\$160	=	( \$8600 - 600 ) x 2/100

**Solution: General Journal Entry**

Date	Particulars	Debit \$	Credit \$
	Bad Debts	600	
	Debtors		600

Date	Particulars	Debit \$	Credit \$
	Doubtful Debts	40*	
	Provision for Doubtful Debts		40

\*increased amount

**Profit and Loss (extract)**

	\$		\$
Bad Debts	600		
Doubtful Debts	40		



### Balance Sheet (extract)

	\$		\$
<b>Current Assets</b>			
Debtors (8600 – 600)	8000		
Less Provision for doubtful debts	<u>160</u>		
	<u>7840</u>		

### 3. To Decrease Provision for Doubtful Debts

#### Example 1:

### Trial Balance (Extract)

	\$		\$
Debtors	\$13400	Provision for Doubtful Debts	2200
Bad Debts	1200		

### Additional Information

1. Wrote off Additional Bad debts \$400
2. The provision for doubtful debts to be 15% of debtors

Formula for Calculating Provision for Doubtful Debts	=	( Debtors – Additional Bad Debts) x Rate/ 100
\$1950	=	( \$13400 - 400 ) x 15/100

### Solution:

### General Journal Entry

Date	Particulars	Debit \$	Credit \$
	Bad Debts	400	
	Debtors		400

Date	Particulars	Debit \$	Credit \$
	Provision for Doubtful Debts	250	
	Doubtful Debts		250

### Profit and Loss (extract)

	\$		\$
Bad Debts (1200+400)	1600	Doubtful Debts	250

### Balance Sheet (extract)

	\$		\$
<b><u>Current Assets</u></b>			
Debtors (13400 – 400)	13000		
Less Provision for doubtful debts	<u>1950</u>		
	<u>11050</u>		



### Activity 4.1.2

#### Multiple Choice and Short Answers

- A Rental income was received in advance on the balance day for \$100. This would result in
  - a decrease in revenue and an increase in current liabilities.
  - an increase in expenses and a decrease in current liabilities.
  - an increase in expenses and a decrease in the current assets.
  - a decrease in the revenue and a decrease in the current liabilities
- State the formula to calculate Doubtful debt.
- Expenses due but not paid on balance day is classified as a \_\_\_\_\_ in the Balance sheet.
- Give 2 reasons why businesses write off bad debts.
- Differentiate between bad debts and doubtful debts.

**Accounting Procedure:**6. **Trial Balance of Ashitosh as at 31 March 2012**

	\$		\$
Debtors	3080	Provision for depreciation	
Purchase	400	Furniture	300
Rate	390	Equipment	500
Insurance	765	Rent	1600
Equipment	2600	Commission	128
Furniture	750		

**Additional Information**

1. Bad debts written off \$180
2. The provision for doubtful debts is to be 2 ½ percent of debtors
3. Rates accrued \$49
4. Insurance unexpired \$108
5. Rent per month is \$70
6. Commission due \$80
7. Depreciate equipment by 6% per annum on cost
8. Provide depreciation on furniture at 2% per annum on cost

**Required:**

- a) Prepare the Journal entries for the above
- b) Prepare the profit and loss extract
- c) Prepare the balance sheet extract

7. **Trial Balance of Pinto as at 31 October 2011**

	\$		\$
Electricity	720	Commission	508
Office expenses	600	Rent	1400
Advertising	1205		
Cleaning expenses	162		
Bad debts	200		
Debtors	8000		

Cartage outwards	666		
Rates and taxes	205		
Insurance	600		

### Balance Day Adjustments

1. Advertisement expense owing to Manasa \$60
2. Commission due \$98
3. Office expenses paid in advance \$600
4. Provision for doubtful debts on debtors \$46
5. Cleaning expense accrued \$162
6. Rent received in advance \$360

#### **Required:**

- a) Prepare the Journal entries for the above.
  - b) Prepare the profit and loss extract.
  - c) Prepare the balance sheet extract.
  - d) Prepare Advertising Account.
  - e) Prepare Rent account.
8. Based on the following information, prepare the appropriate adjusting entries in the general journal. The balance day falls on 30 June 2014
1. Payroll payment is \$50000 for a five day work week ending on Friday. June 30<sup>th</sup> is on Tuesday.
  2. On 1<sup>st</sup> May 2014 a company paid three months fire insurance premium of \$375
  3. Dividend from Fiji TV is due but not received on balance day \$150
  4. Kin Wah's account of \$100 written off
  5. A provision to be credited for doubtful debts of \$300
  6. On 1<sup>st</sup> April 2014, the company received \$1200 of rent from sublet for one year

## 4.2 WORKSHEET AND FINAL ACCOUNTS

### **Accounting Reports and its purpose:**

Financial reports are prepared by the accountants on the basis to help the end users in decision making.

### **Features of a good Accounting Report**

Accounting report has several distinctive features.

- ➡ **Clear heading** –accounting reports must have a clear heading showing the name of the business, the title of the report, date and the time period relevant to information in the report.
- ➡ **Timeliness**- accounting information should be made available early enough to allow decisions to be made without undue delay.
- ➡ **Accuracy** – accounting reports must be as accurate as possible to enable correct decisions to be made.
- ➡ **Simplicity**- reports must be simple enough to be understood by the intended users .
- ➡ **Consistency** - accounting reports from one accounting period to next should be prepared on a consistent basis so that the results of one accounting period can be compared with the next.
- ➡ **Clear presentation**- accounting information should be clearly presented in order to be understood.
- ➡ **Compliance with law and accounting standard** –accounting reports must be prepared in accordance with Fiji accounting standards.

**Comparative financial statements** are the complete set of financial statements that an entity issues, revealing information for more than one accounting period.

### **Why Need for Comparative Statements**

- ✚ Provides a comparison of an entity's financial performance over multiple periods. The statements may also reveal unusual items in the reported information that can indicate the presence of accounting errors.
- ✚ Provides a comparison of expenses to revenues and the proportions of various items on the balance sheet over multiple periods. This information can be useful for cost management purposes.

- ✚ Useful for predicting future performance.
- ✚ When comparing different companies, a comparative statement can show how businesses react to market conditions affecting an entire industry.

### **Limitations of Traditional Reports**

- ✚ Does not consider non-financial information.
- ✚ Reports are based on historical data reported in the financial statement.
- ✚ Pictorial analysis is not commonly practiced under traditional approach.

### ➡ **Worksheet**

The worksheet is a nature of a blueprint divided into various columns which assists the accountant to collect and organize the information relating to formulate financial statements .

### **Procedure for preparing the worksheet:**

#### **1. Trial Balance Column**

Ledger account balances to be entered in the correct columns of the Trial Balance Debit must equal to credit side.

#### **2. Adjustments column**

All adjustments to be entered on the Dr or Cr side. New entries to be done below the Trial balance totals.

#### **3. Adjusted Trial Balance Column**

Figures derived from the adjustment columns are added or subtracted from the trial balance to gage the amount that will be entered in the revenue statement and the balance sheet.

#### **4. Revenue Statement**

Transfer all income and expense items from the adjusted trial balance to these columns to find out the net profit or loss. The difference between the two columns represents Net profit/loss.

#### **5. Balance Sheet**

From the adjusted Trial balance transfer the A, L, and capital to the balance sheet.

### **Example:**

**GINI Fiji prepared the following Trial Balance:**

**GINI**  
**Trial Balance as at 31<sup>st</sup> March 2015**

	\$		\$
Insurance	400	Capital	49740
Machinery	34000	Commission	2000
Office expenses	1650	Creditors	8000
Drawings	2900	Sales	30900
Bank	2400		
Account Receivables	6700		
Equipment	20000		

Purchases	17140		
Rent	1500		
Inventories 1 Aril 2014	2100		
Wages	1850		
	<b>90640</b>		<b>90640</b>

### Adjustments:

Wages Accrued \$200  
Rent paid in advance \$300  
Commission revenue earned but not yet received \$30  
Inventories @ 31<sup>st</sup> March 2015 \$2300

### Worksheet of GINI for the year ended 31<sup>st</sup> March 2015

	Trial Balance		Adjustments		Amended Trial Balance		Rev Statement		Balance Sheet	
	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr
<b>Insurance</b>	400				400		400			
<b>Machinery</b>	34000				34000				34000	
<b>Office expenses</b>	1650				1650		1650			
<b>Drawings</b>	2900				2900				2900	
<b>Bank</b>	2400				2400				2400	
<b>Account Receivables</b>	6700				6700				6700	
<b>Equipment</b>	20000				20000				20000	
<b>Purchases</b>	17140				17140		17140			
<b>Rent</b>	1500			300	1200		1200			
<b>Inventories 1 Aril 2014</b>	2100				2100		2100			
<b>Wages</b>	1850		200		2050		2050			
<b>Capital</b>		49740				49740				49740
<b>Commission</b>		2000		30		2030		2030		
<b>Creditors</b>		8000				8000				8000
<b>Sales</b>		30900				30900		30900		
	<b>90640</b>	<b>90640</b>								
<b>Wages Accrued</b>				200		200				200
<b>Rent paid in advance</b>			300		300				300	
<b>Commission revenue accrued</b>			30		30				30	
<b>Inventories 31<sup>st</sup> March 2015</b>								2300	2300	
<b>Net profit</b>							10690			10690
			<b>530</b>	<b>530</b>	<b>90870</b>	<b>90870</b>	<b>35230</b>	<b>35230</b>	<b>68630</b>	<b>68630</b>



## Activity 4.2.1

### **Worksheet**

1. The Trial Balance as at 31/3/14 of N Dell, a lawyer is given below

	\$	\$
Bank	120000	
Drawings	97000	
Debtors	15000	
Car (cost)	65000	
Lease expense of office	28000	
Creditors		9760
Capital		40000
Administrative expense	14050	
Wages	127000	
Fees		421930
Accumulated Depreciation		
Car		16250
Equipment		3000
Insurance		
Car	1400	
Equipment	950	
Office equipment(cost)	21000	
Interest on loan	290	
Loan		2900
Lighting	1200	
Vehicle expenses	2950	
	<b>493840</b>	<b>493840</b>

*Extracted From: Form5 Accounting Revision*

The following adjustments were to be made:

- \$200 of car insurance is prepaid
- \$250 for administration expenses is owing.
- Depreciation is to be provided (straight line for the car 12.5%) and the equipment \$3000.
- Fees owing but not yet received \$1930.

### **Required:**

Prepare final account by using a worksheet.



2. Given below is the unadjusted trial balance of Jashpal Singh for the year ended 31<sup>st</sup> March 2014.

**Trial Balance Of Mr Jashpal Singh As At 31<sup>st</sup> March 2014**

<b>Ledger accounts</b>	<b>Dr (\$)</b>	<b>Cr (\$)</b>
Stock at 01/04/13	5 580	
Net purchase	22 500	
Wages	8 550	
Advertising expenses	3 265	
Buildings	48 600	
Plant	10 000	
Cash at bank	6 251	
Accounts receivable	2540	
Office expenses	2 480	
Drawings	4 000	
Insurances	600	
Sales		48 555
Interest received		190
Accumulated depreciation on plant		2 000
Accounts payable		2 840
Commission received		590
Capital - Jashpal Singh		60 191
<b>Total</b>	<b><u>\$ 114 366</u></b>	<b><u>\$ 114 366</u></b>

**The following adjustments are requires at the balance date**

- (a) Wages due but not paid \$150
- (b) Insurance paid in advance \$188.

- (c) Commission due but not received \$50
- (d) Interest received in advance \$30.
- (e) Depreciate plant at 10% per annum on straight line method.
- (f) Create provision for doubtful debts equal to 5 % of the debtors.
- (g) Stock at 31/03/14 \$2500.

**Required:** Using the information given above prepare the Worksheet for the year ended 31/3/14.

## **Preparation of Final Accounts**

Final Accounts mainly comprises of Statement of Financial Performance and Statement of Financial Position. Traditionally these statements were known as Revenue Statement and Balance Sheet. In reality, firms are mostly using Vertical/ modern/ statement forms to present their Financial Reports.

### **Trading Account (Component of Statement of Financial Performance)**

- Simply shows the gross profit or loss derived by the business on purchases and sales of goods and services.

1. Net Purchases = Total Purchases – Purchase returns(returns outwards)
2. Net Sales = Total Sales - Sales returns ( return inwards)
3. Goods available for Sale = Opening stock + Net Purchases + Buying expenses
4. Cost of Goods Sold = Goods available for Sale – Closing stock
5. Gross profit = Net Sales > Cost of Goods sold ( appears on debit side of trading account)
6. Gross Loss = Net sales < Cost of Goods sold ( appears on the credit side of trading account)

### **Profit and Loss Account (Component of Statement of Financial Performance)**

Shows revenue and expenses together with gross profit or loss to calculate the net Profit/loss. (T Form).

## **Statement of Financial Performance ( Revenue Statement)**

-is a summary statement of expenses and revenues to calculate net profit or loss.

## **Classification of Revenue and Expenses in the Statement of Financial Performance**

**1. Operating Expenses – are those that incurs in the normal running of the business.**

### **Selling and Distribution Expenses**

- are expenses incurred in connection with selling, delivering, storage, promotion and distribution of goods and services.

<b>Delivery vehicle expenses</b>	<b>Cartage outwards</b>
<b>Depreciation – delivery vehicle</b>	<b>Commission expenses</b>
<b>Salesman’s wages</b>	<b>Advertisements</b>
<b>Depreciation – Plant</b>	<b>Travel expenses</b>
<b>Depreciation- Storage room</b>	<b>Store man’s salary</b>
<b>Depreciation – equipments used in sales</b>	<b>Salesman’s car expenses</b>
<b>Repairs and maintenance- storage, delivery vehicle</b>	<b>Depreciation – showroom</b>
	<b>Warehouse expenses</b>

### **Administrative Expenses**

- are expenses associated with the overall management of the business. Examples:

<b>Rates and taxes</b>	<b>Lighting and Power</b>
<b>Cleaning</b>	<b>Depreciation – Building</b>
<b>Telephone</b>	<b>Depreciation – Fixtures and Fittings</b>
<b>Rent</b>	<b>Depreciation – Office Equipment</b>
<b>Insurance</b>	<b>Depreciation – Administrative car</b>
<b>Office expenses</b>	<b>Repairs and Maintenance</b>
<b>Accounting fees</b>	<b>Accidents compensation</b>
<b>Audit fees</b>	<b>Oil and petrol</b>
<b>Printing and Stationery</b>	<b>Legal expenses</b>
<b>General expenses</b>	<b>Bank charges</b>
<b>Salaries and Wages</b>	

### **Financial Expenses**

- are expenses in connection with collecting debts, paying interest and allowing discounts .

<b>Bad debts</b>	<b>Interest</b>
<b>Doubtful debts</b>	<b>Interest on Mortgage</b>
<b>Discount allowed</b>	<b>Interest on debenture</b>
<b>Interest on overdraft</b>	<b>Interest on loan</b>

### **Non-Operating Expenses**

- are expenses incurred but not in the normal course of the business.

<b>Donations</b>	<b>Theft</b>
<b>Losses on sale of assets</b>	<b>Damage caused by fire, flood on stock or building</b>

### **3. Operating Gain**

- are income generated during the normal course of the business.

Examples:

<b>Commission received</b>	<b>Bad debts recovered</b>
<b>Discount received</b>	<b>Doubtful debts (Decrease)</b>

### **4. Non – Operating Gain**

-are income earned from outside the normal operation of the business. Examples:

<b>Gain on sale of fixed assets</b>	<b>Rent income from sub-let</b>
<b>Dividends</b>	<b>Interest on investments</b>
<b>Interest on fixed term deposit</b>	

### **Statement of Financial Position ( Balance Sheet)**

- is a statement of assets, liabilities and proprietorship. It shows the financial position of a business at a particular point in time.

#### **Current Assets**

- are those which are converted into cash within a financial year Eg. Cash at bank, inventory, Accounts receivables.

#### **Fixed Assets**

- are those assets which are used in the business for more than one year. It is also known as Property, Plant and Equipment and Non-current asset.

#### **Intangible Assets**

- are those assets which have no physical substance i.e. they cannot be seen or touched E.g.: Goodwill, Patents rights, copy right.

#### **Investments**

- are money invested outside the business which generates income. E.g. Term Deposit, Government bond, Shares in TT Co. Ltd.

#### **Current Liabilities**

- debts that must be paid within a year. E.g. Accounts Payable, Bank Overdraft.

#### **Long Term liabilities**

- Those debts that are paid after one year. E.g. Mortgage.

**Mortgage** is a secured loan on property. The mortgager has full right to seize the property in case of nonpayment of loan.

**Proprietorship** –is the owner’s investment in the business plus the net profit less drawings.

## Vertical Presentation of the financial statements

### **Format of Statement of Financial Performance**

#### **Statement of Financial Performance of \_\_\_\_\_**

For the year ended xx December 20xx

	\$	\$	\$
Sales		xx	
Less sales returns		xx	
Net Sales			xx
<b><i>Less Cost Of Goods Sold</i></b>			
Opening Stock		xx	
Add Purchases	xx		
Less Purchases Returns	<u>xx</u>	xx	
Add Customs Duty/Freight Inwards		<u>xx</u>	
<b>Goods made Available for Sale</b>		xx	
Less Closing Stock		<u>xx</u>	
Cost of Goods Sold			<u>xx</u>
Gross profit /Loss			xx
<b>Add Operating Gains</b>			
Bad debts recovered		xx	
Doubtful debts (decrease)		xx	
Discount received		<u>xx</u>	xx
			xx
<b><i>Less Operating Expenses</i></b>			
<b><i>Selling and Distribution Expense</i></b>			
Salesman's wages	xx		
Advertising	xx		
Delivery vehicle expense	xx	<u>xx</u>	
<b><i>Administrative Expenses</i></b>			

Insurance	xx		
Salaries	xx		
Repairs and maintenance	xx	<u>xx</u>	
<b>Financial Expenses</b>			
Discount allowed	xx		
Interest on loan	xx		
Bad debts	xx		
Interest on Mortgage	xx		
Doubtful debts ( creating and increasing)	<u>xx</u>	<u>xx</u>	
Total Operating Expenses			xx
<i>Net Operating Profit</i>			xxx
<b>Add Non – Operating Gain</b>			
Dividend		xx	
Rent – sub lease		<u>xx</u>	xx
			xxx
<b>Less Non- Operating Expense</b>			
Donations		xx	
Loss on sale of fixed assets		<u>xx</u>	<u>xx</u>
<b>Net Profit</b>			<b><u>xxxx</u></b>

**Format of a Statement of Financial Position****Statement of Financial Position of \_\_\_\_\_****As at xx December 20xx**

	\$	\$	\$
Capital		xx	
Add Net profit		xx	
		xx	
Less Drawings		xx	<u>xxx</u>
<b>This is represented by:</b>			
<b>Current Assets :</b>			
Closing stock/Inventory	xx		
Cash at bank/ on hand/in hand	xx		
Expense prepaid	xx		
Income due	xx		
Accounts receivable xx			
Less provision for doubtful debts ( actual amount) <u>xx</u>	<u>xx</u>	xx	
<b>Less Current Liabilities</b>			
Creditors/ Accounts payable	xx		
Bank overdraft	xx		
Income received in advance	xx		
Expense due	<u>xx</u>	xx	
<b>Working capital</b>			xx
<b>Add Fixed Assets</b>			
Land and building		xx	
Equipment	xx		
Less provision for depreciation	<u>xx</u>	<u>xx</u>	xx
<b>Add Intangible Asset</b>			
Goodwill			xx



<b>Add Investments</b>			
Government bond		xx	
Shares in AA Ltd		<u>xx</u>	xx
<b>Less Long Term Liabilities</b>			
Mortgage			<u>xx</u>
			<b><u>xxx</u></b>

### **Example:**

Samu owns and operates a store in Sigatoka. The unadjusted trial balance for the year ended 31<sup>st</sup> March 2013 is given below:

Trial Balance of SM Enterprise as at 31<sup>st</sup> March 2013.

<b>Ledger Accounts</b>	<b>Dr \$</b>	<b>Cr \$</b>
Stock at 1/04/12	11160	
Net purchases	45000	
Wages	17100	
Utility Expense	6530	
Building at cost	97200	
Plant	20000	
Cash at bank	12502	
Accounts Receivables	5080	
Office expenses	4950	
Drawings	8000	
Insurance	1200	
Sales		97100
Interest Received		380

Provision for depreciation on Plant		4000
Accounts Payable		5680
Commission Received		1180
Capital - Samu		120382
Total	<b><u>228722</u></b>	<b><u>228722</u></b>

(Source: Accounting 5 by A. Shariff)

The following Adjustments are required at the balance date:

1. Wages due but not paid \$160.
2. Insurance unexpired \$180.
3. Commission due but not received \$60.
4. Interest received in advance \$40.
5. Depreciate plant at 10% per annum on straight line basis.
6. Create Provision for doubtful debts to 5% of the accounts receivables.
7. Stock at 31/03/13 \$3500.

Prepare fully classified Statement of Financial Performance and statement of Financial Position for the period ending 31/3/13.

**Solution:**

**Statement of Financial Performance of SM Enterprise**

**For the Year ended 31<sup>st</sup> March 2013.**

	\$	\$	\$
Sales			97100
Less Cost of Goods Sold:			
Opening Inventory		11160	
Add Net purchases		<u>45000</u>	
Goods Made Available for Sale		56160	
Less Closing Inventory		<u>3500</u>	52660

Gross Profit			44440
<b>Add Operating Gains</b>			
Commission Received (1180 + 60)		1240	
Interest (380 – 40)		<u>340</u>	<u>1580</u>
			46020
<b>Less Operating Expenses:</b>			
<b>Selling &amp; Distribution Exp</b>			
Depreciation on Plant	<u>2000</u>	2000	
<b>Administrative Expense</b>			
Wages (17100 +160)	17260		
Utility Expense	6530		
Office Expense	4950		
Insurance (1200 – 180)	<u>1020</u>	29760	
<b>Financial Expense</b>			
Doubtful Debts		<u>254</u>	
<b>Total Operating Expenses</b>			<u>32014</u>
<b>Net Operating Profit</b>			<b>14006</b>
<b>Less Non-Operating Expense</b>			-
<b>Net profit</b>			<b><u>14006</u></b>

## Statement of Financial Position of SM Enterprise

As at 31<sup>st</sup> March 2013.

	\$	\$	\$
<b>Proprietorship</b>			
Capital		120382	
Add Net profit		<u>14006</u>	
		134388	
Less Drawings		<u>8000</u>	<b><u>126388</u></b>
This is represented by:			
<b>Current Assets:</b>			
Inventories	3500		
Cash	12502		
Accounts Receivables( 5080 – 254)	4826		
Insurance Prepaid	180		
Commission Due	<u>60</u>	21068	
<b>Less current Liabilities:</b>			
Wages Due	160		
Interest Rec. In Advance	40		
Accounts Payable	<u>5680</u>	5880	
Working Capital			<b>15188</b>
<b>Fixed Assets</b>			
Building		97200	
Plant (20000 – 6000)	20000		
Less Provision for Depre. on Plant	<u>6000</u>	<u>14000</u>	111200
			<b><u>126388</u></b>



### Activity 4.2.3

#### Multiple Choice

1. Cartage paid for goods bought for resale will be classified in the Statement of Financial Performance as:
  - A. Operating Expense
  - B. Buying Expense
  - C. Selling and Distributive expense
  - D. Administrative Expense.
2. A decrease in doubtful debt would be regarded as a
  - A. Operating Expense
  - B. Financial Expense
  - C. Operating Revenue
  - D. Non-operating revenue
3. The Statement of Financial Performance of a business showed total expense of \$90,000 at year end. The Statement of Financial Position at the same date showed prepayments of \$1,200 and accrued expenses of \$4,300. The actual cash paid for expenses during the year is
  - A. \$84,500
  - B. \$85,700
  - C. \$86,900
  - D. \$93,100

## **Final Accounts**

4. Prasad & Sons sells groceries in Ba. Given below is the Trial balance for the business.

### **Trial Balance of Prasad & Sons as at 31 August 2014**

	\$		\$
Drawings	500	Capital	3000
Furniture and Fittings	550	Purchase returns	150
Motor vehicles	700	Sales	8390
Stock – 1/09/2013	1000	Sundry creditors	680
General expenses	400	Discount received	80
Wages and Salaries	1275	Rent income	520
Cartage Inwards	175	Commission received	780
Purchases	1720	Provision for depreciation	
Sales Returns and Allowance	85	Furniture and Fittings	165
Theft	80	Motor Vehicle	280
Rent	812	Dividend from shares	247
Rates and Taxes	40		
Discount allowed	25		
Insurance	10		
Debtors	1200		
Advertising	50		
Cash at bank	4300		
Bad debts	70		
Showroom	<u>1300</u>		<u>          </u>
	<b><u>14292</u></b>		<b><u>14292</u></b>

Stock at 31 August 2014 \$320

### **Required:**

Prepare Statement of Financial Performance of Prasad & Sons for the year ended 31 August 2014.

### 5. Trial Balance of Kumar Supermarket as at 30<sup>th</sup> June 2012

	\$	\$
Capital		9000
Sales		7860
Purchases Returns		200
Bank		800
Bad Debts	150	
Selling Expenses	760	
Rent – Top Floor		430
Commission		550
Cartage Inwards	180	
Delivery Vehicle	12600	
Provision for depreciation on delivery vehicle		600
Light and Power	180	
Insurance	500	
Account Receivables	940	
Accounts Payable		430
Loan from FDB (Payable in 5 years)		6000
Building	4800	
Stock 1/7/2011	3400	
Government Bond	1000	
Purchases	1310	
Interest on Loan	50	
	<b>25870</b>	<b>25870</b>

### Additional Information

1. Stock on hand, 30<sup>th</sup> June 2012 \$900

2. Bad debts written off \$40
3. Make a provision for doubtful debts equal to 4 percent of accounts receivable
4. Depreciate delivery vehicle at 10 percent on cost
5. Provide depreciation on Building: economic life is 6 years and scrap value of \$800
6. Four months interest on loan at 10 percent per annum is due
7. Rent received in advance \$150
8. Insurance Prepaid \$80

**Required:** Prepare the Fully classified Statement of Financial Performance.

6. The following is the unadjusted Trial Balance of Jessie as at 30<sup>th</sup> June 2014.

	<b>Debit \$</b>	<b>Credit \$</b>
Drawings	450	
Furniture and fittings at cost	4400	
Capital		2900
Cost of Sales	1645	
Sales		4350
Administrative expense	1525	
Financial expense	200	
Selling Expense	200	
Accounts Receivables	1240	
Cash at bank	380	
Provision for doubtful debts		70
Accounts Payable		690
Accumulated Depreciation – Furniture and fittings		720
Commission Received		750
Rent Received		560
	<b>10040</b>	<b>10040</b>

The following adjustments are required as at 30<sup>th</sup> June 2014:

1. Wages and salaries due but unpaid \$29
2. Commission earned but not received \$20
3. Rent for the new year received in advance \$15
4. Provides depreciation on furniture and fittings at 10% per annum using fixed installment method



5. Wrote off bad debts \$40
6. Adjust provision for doubtful debts to 5% of debtors

**Additional Information**

- Closing stock \$1000
- Net profit for the period \$2596

**Required:**

- a) Prepare the General journal entries necessary to show the effect of the above adjustments.
- b) Prepare a fully classified Statement of Financial Position of Jessie as at 30<sup>th</sup> June 2014.

7. The following ledger account details have been taken from the books of S Enterprise for the year ending 30/06/12.

<b><u>Ledger Account Details</u></b>	<b><u>Amounts \$</u></b>
Cash at bank	860
Accounts Receivables	4000
Provision for doubtful debts	80
Prepaid Advertising	236
Stock on hand 30/6/2012	1300
Capital at 1/7/2011	11855
Plant	3500
Buildings	6000
Provision for depreciation-plant	650
Provision for depreciation-building	1000
Good will	3000
Loan	1100
Interest due but not paid	293
Drawings	3000
Accounts Payable	4200
Profit and loss – Net profit	2718

**Required:** Prepare a fully classified Statement of Financial Position in modern/vertical form of S. Enterprise as at June, 2012.

# ANALYSIS AND INTERPRETATION OF FINANCIAL STATEMENT - 1



## Strand Outcome

Apply knowledge of financial reporting to vertically analyze the final accounts of a sole trader.

## Learning Outcomes

- Analyze the financial reports of a sole proprietor to assess its performance

STRAND

5

## 5.1 ANALYSING ACCOUNTING REPORTS - VERTICAL

### RATIO ANALYSIS OF A SOLE TRADER

Financial statements are statements based on historical, facts and figures. They reflect a careful combination of recorded facts, accounting principles, concepts and conventions, personal judgments and sometimes estimates. In accounting ratios are used to analyze and interpret the accounting data. This helps the business to compare ratios and performances with those in the same industry.

Analysis of Financial Statements – is generally the calculation of ratios and percentages  
Interpretation of Financial statements – is commenting on the ratios, which will aid in decision making.

There are **three** sets of ratios and percentages:

- ➡ Profitability Ratios
- ➡ Financial Stability Ratios
- ➡ Management Effectiveness ratio

### Measures of Earning Capacity / Profitability Ratios

**Earning capacity or ability to maintain or improve profitability is one of the most important objectives of any business entity. This is an area of interest to all types of end users of accounting data**

	<b>Ratio</b>	<b>Formula</b>	<b>Purpose/ Significance</b>
<b>1</b>	Gross profit ratio <b>or</b>  Gross Profit %	$\frac{\text{Gross profit}}{\text{Net Sales}}$ <p style="text-align: center;">OR</p> $\frac{\text{Gross Profit} \times 100}{\text{Net Sales} \quad 1}$	<p><b>-measures the gross profit earned per dollar of sales</b></p> <p><b>- it indicates the margin of profit available to cover operating expenses</b></p> <p><b>High gross profit is important to the business's economic viability.</b></p> <p><b>Declining gross profit means low sales margin and expensive buying.</b></p>
<b>2</b>	Net profit ratio <b>or</b>  Net Profit %	$\frac{\text{Net profit}}{\text{Net Sales}}$ <p style="text-align: center;">Or</p> $\frac{\text{Net Profit} \times 100}{\text{Net Sales} \quad 1}$	<p><b>- measures net profit per dollar of sales</b></p> <p><b>- indicates net margin per dollar after all expenses</b></p> <p><b>- High net profit means high profits.</b></p> <p><b>- Net Profit is dependent on the gross profit and volume of sales.</b></p>
<b>3.</b>	Return on owners' equity ratio   or  Return on owners' equity %	$\frac{\text{Net profit}}{\text{Av/ Closing capital}}$ <p style="text-align: center;">or</p> $\frac{\text{Net profit} \times 100}{\text{Av/Closing capital} \quad 1}$ <p style="text-align: center;">Average capital = opening capital + closing capital ÷ 2</p>	<p><b>- measures return on investments or assets provided by the owner</b></p> <p><b>- measures how effectively invested funds are used</b></p>
<b>4</b>	Rate of return on total assets ratio  Or Rate of return on total assets %age	$\frac{\text{Net profit} + \text{interest expense}}{\text{Average total assets}}$ $\frac{\text{Net .Op profit} + \text{int exp} \times 100}{\text{Average total assets} \quad 1}$	<p><b>- measures the net profit derived from every dollar of asset employed by the business</b></p>

5	Expense to sales ratio  Or  Expenses to sales percentage	<u>Total operating expenses</u>  Net sales  OR  <u>Total Op. expenses</u> × <u>100</u>  Net sales                      1  <b>Individual expenses</b> a) <u>Selling and Dist Exp</u> × <u>100</u>  Net sales                      1  b) <u>Administrative Expense</u> × <u>100</u>  Net sales                      1  c) <u>Financial Expense</u> × <u>100</u>  Net sales                      1	- measures the ratio of expenses in relation to the sales dollar
6	Mark – up Ratio      Mark Up %	<u>Gross Profit</u>  Costs of Goods Sold  OR  <u>Gross profit</u> x <u>100</u>  Cost of goods sold    1	- measures the gross profit based on the cost price
B	<u>Measures of Financial Stability or Liquidity Ratios</u>  Means the ability to meet financial requirements in both short term and long term so that the business could continue to operate as usual		
1	Working capital/current or solvency ratio	<u>Current Assets</u>  Current Liabilities	- measures the ability to meet current debts

	<p>OR</p> <p>Working Capital %age</p> <p>OR</p> <p>Working Capital in \$</p>	<p>OR</p> $\frac{\text{Current Assets}}{\text{Current Liabilities}} \times 100$ <p>OR</p> $\text{CA} - \text{CL} = \$$	<p><b>with the current assets</b></p> <ul style="list-style-type: none"> <li>- <b>the rule of thumb is 2:1</b></li> <li>- <b>it indicates the ability of the business to meet its debts as it falls due in the short term 3-6 months</b></li> </ul>
<b>2.</b>	<p>Quick Asset or Acid Test or Liquid Capital ratio</p> <p>Quick Asset %</p>	<p><math>\frac{\text{CA} - \text{Cl stock -prepayment}}{\text{CL} - \text{Bank overdraft secured}} \times 100</math></p> <p>OR</p> <p><math>\frac{\text{Quick Assets}}{\text{Quick Liabilities}} \times 100</math></p> <p>Quick Assets = Current Assets – (closing stock + prepayment)</p> <p>Quick Liabilities = current liabilities – bank overdraft (limit)</p>	<ul style="list-style-type: none"> <li>- <b>measures the ability to meet immediate debts using the most liquid assets</b></li> <li>- <b>the rule of thumb is 1:1</b></li> </ul>
<b>3</b>	<p>Proprietorship ratio / Owners Equity / Equity ratio</p> <p>Proprietorship %</p>	<p><math>\frac{\text{Owners' Equity}}{\text{Total Assets}} \times 100</math></p> <p>OR</p> <p><math>\frac{\text{Owners' Equity}}{\text{Total Assets}} \times 100</math></p>	<ul style="list-style-type: none"> <li>- <b>measures the percentage of assets or funds provided by the owners</b></li> <li>- <b>the ratio should at least be 50%, a very high level shows overcapitalization by the owners</b></li> </ul>
<b>4</b>	<p>Debt ratio</p>	<p><math>\frac{\text{Total External Liabilities}}{\text{Total Assets}} \times 100</math></p> <p>OR</p>	<ul style="list-style-type: none"> <li>- <b>measures the amount of assets or funds provided by the external parties</b></li> <li>- <b>the acceptable level is below 50%</b></li> </ul>

	Debt to total asset %	$\frac{\text{Total Ex Liabilities} \times 100}{\text{Total Assets}}$	
5.	Debt to Equity Ratio based on liabilities  Debt to Equity %	$\frac{\text{Total External Liabilities}}{\text{Owners' Equity}}$ Or $\frac{\text{Total Ex. Liabilities} \times 100}{\text{Owners Equity}}$	<p>- <b>measures the outsiders claim in relation to the owners' equity</b></p> <p>- <b>the acceptable level is below 50%</b></p>
C	<p><b><u>MEASURES OF THE EFFECTIVENESS OF CERTAIN MANAGEMENT POLICIES</u></b></p> <p><b>All ratios and percentages indicate the effectiveness of the management in controlling and managing their resources to its best advantage. However, some results are specifically related to certain policies of the management</b></p>		
1	Rate of inventory turnover  OR Rate of Stock Turnover in Days/Months/ Weeks	$\frac{\text{COGS}}{\text{Av. Stock}}$ OR $\frac{\text{Av. Stock}}{\text{COGS}} \times \text{days/ Wks/months}$	<p>- <b>measures how quickly inventory is sold</b></p> <p>- <b>measures the number of times during the period that average inventory is sold</b></p>
2.	Debtors turnover Or Accounts Receivable turnover in Days/Months/Weeks	$\frac{\text{Net credit sales}}{\text{Average debtors}}$ $\frac{\text{Av. debtors}}{\text{Net Credit sales}} \times \text{days/ wks/months}$	<p>- <b>measures the time taken by the debtors to pay their debts</b></p> <p>- <b>It indicates how quickly accounts receivable or debtors pay their debts and helps the business to judge the effectiveness of credit control and collection policies.</b></p> <p><b>Greater the time taken by debtor to settle their accounts, greater will be the incidence of bad and doubtful debts</b></p>

## ➡ **Limitations of Ratio Analysis**

1. Items that cannot be quantified in monetary terms are not included in the ratio analysis.
2. Single year's figures are meaningless unless compared to the previous year of the business trend.
3. Calculations are based on historical cost ignoring the changes in the price level.
4. Different businesses may have different accounting policies which make comparison rather difficult in the same industry.

### Example

The following statements have been prepared for the KCF Company for the year ended 31 March 2013.

#### **Statement of Financial Performance for KCF Enterprise**

##### **For the year ended 31 March 2013**

	2013 \$		
Net sales (50% credit)		15 000	
Less cost of goods sold		<u>10 000</u>	
Gross profit			5 000
<i>Less Operating Expenses</i>			<u>4 000</u>
Net profit			<u>1 000</u>

#### **Statement of Financial Position for KCF Enterprise**

##### **As at 31 March 2013**

<b><u>Owners Equity</u></b>	\$	\$	\$
Capital		30 000	
Add Net profit		<u>1 000</u>	
		31 000	
Less Drawings		<u>3 000</u>	<u>28 000</u>
This is represented by:			
<b><u>Current Assets</u></b>			
Debtors	2 850		



Stock	<u>8 700</u>	11 550	
<b>Current Liabilities</b>			
Bank	1 300		
Creditors	<u>4 000</u>	<u>5 300</u>	
Working Capital			6 250
<b>Add Non – Current Assets</b>			<u>35 900</u>
<b>Less Non – Current Liabilities</b>			42 150
Mortgage			<u>14 150</u>
			<u>28 000</u>

### Required:

A. Calculate the following ratios and percentage for 2013 correct to two decimal place

#### **Show all working**

- Mark – up %
- Gross profit ratio
- Net profit %
- Total Operating Expense %
- Return on owners' Equity ratio
- Acid test ratio
- Debtors turnover in number of times

### Solution:

	Formula	Working	Answer
<b>a)</b>	Mark – up %		
	$\frac{\text{Gross profit}}{\text{Cost of goods sold}} \times \frac{100}{1}$	$\frac{5000}{10000} \times \frac{100}{1}$	
			<b>50%</b>
<b>b)</b>	Gross profit ratio		
	$\frac{\text{Gross profit}}{\text{Net Sales}}$	$\frac{5000}{15000}$	
			<b>0.33 : 1</b>

<b>c)</b>	Net profit %  $\frac{\text{Net profit}}{\text{Net Sales}} \times \frac{100}{1}$	$\frac{1000}{15000} \times 100$	<b>6.67%</b>
<b>d)</b>	Total Operating Expense %  $\frac{\text{Operating Exp}}{\text{Net Sales}}$	$\frac{4000}{15000} \times 100$	<b>26.67%</b>
<b>e)</b>	Return on owners' Equity ratio  $\frac{\text{Net profit}}{\text{Owners' Equity}}$	$\frac{1000}{28000}$	<b>0.04:1</b>
<b>f)</b>	Acid test ratio  $\frac{\text{CA} - (\text{Cl stock} + \text{prep})}{\text{CL} - \text{Bank overdraft secured}}$	$\frac{11550 - (8700 + 0)}{5300 - 0}$	<b>0.54:1</b>
<b>g)</b>	Debtors turnover in number of times  $\frac{\text{Net credit sales}}{\text{Average debtors}}$	$\frac{7500}{2850}$	<b>2.63 Times</b>



### Activity 5.1.1

1. Which of the following indicates the short term financial stability of the business?
  - A. Net profit ratio
  - B. Working capital
  - C. Return on Total assets
  - D. Debtors Turnover

2. Raki's Enterprise's financial position as at 31 December, 2013 was:

Current Assets \$45000	Fixed Assets \$125000
Current Liabilities \$22000	Term Liabilities \$38000
Capital – Sami \$110 000	

From the above information, the Debt to Equity percentage of the business would be:

A. 64.70 %

B. 54.55 %

C. 34.54 %

D. 20.00 %

3. One of the limitations of analysis and interpretation of financial statements is that it

A. allows comparison

B. helps in making decisions

C. is based on historical cost

D. helps to identify strengths and weaknesses

4. The following information concerns a local business as at 30<sup>th</sup> June 2014

Total assets	\$500 000
Non-current assets	\$350 000
Current liabilities	\$50 000
Equity ratio	0.75:1

Calculate the current ratio for the business

A. 0.33:1

B. 0.46:1

C. 2.33:1

D. 3.0:1

5. Young had the following account balances: Sales \$160 000, COGS \$46 000, total expenses \$6 240.

What was his net profit percentage?

A. 63.50%

- B. 59.5%
- C. 67.35%
- D. 28.75%

6. CK's business operates in Suva. Given below is the Statement of Financial Position as at 31 October 2014

	\$	\$	\$
<b>Proprietorship</b>			
Capital – Kaila Yee		100000	
Add Net profit		40000	
Less Drawings		10000	<u>130000</u>
Represented by:			
<b>Assets</b>			
Cash	40000		
Accounts Receivables	35000		
Property & Equipment	125000		
Inventory	10000	<u>210000</u>	
<b>Less liabilities</b>			
Creditors	25000		
Loan ( Payable in 5 yrs)	55000	<u>80000</u>	
			<u>130000</u>

Additional Information

1. Sales all credit \$200 000
2. Gross profit \$44 000
3. Opening stock \$38 000
4. Account Receivables 31<sup>st</sup> October 2013 \$33 000

**Required:**

- a) Using the information above, calculate the following ratios and percentages for the year 2014. Show the formula and full working.
  1. Gross profit to sales ratio
  2. Net profit to sales percentage
  3. Acid test ratio
  4. Rate of stock turnover (days)
  5. Accounts Receivable turnover
  6. Working capital in dollars

## 7. Mark – up ratio

7.Mr. Tuisese is concerned about the profitability and financial structure of his business.

**Given below are the financial highlights.**

Particular	30/06/2013 (\$)
Sales (credit)	40 000
Cost of Sales	26 000
Net Profit	8 000
Cash at Bank	8 000
Bank Overdraft (Limit \$2 000)	-
Inventory	12 000
Trade Debtors (Net)	8 000
Creditors	14 000
Capital – Mr. Tuisese	40 000
Non-Current Liabilities	20000
Non-Current Assets (Net)	46 000

### Required:

(a) Calculate the following ratios and percentage for the **years 2013 to 2 decimal place by providing the formula and showing full working:**

- (i) Gross Profit percentage
- (ii) Return on Total assets percentage
- (iii) Owner's Equity Ratio
- (iv) Mark Up Percentage
- (v) Working Capital in dollar
- (vi) Quick Asset Ratio
- (vii) Age of Debtors (No. of months)

8.

Given below is the balance sheet of Johnson Store for the year ending 30<sup>th</sup> June, 2013

	30 <sup>th</sup> June, 2013	
Current Assets	\$	\$
Accounts Receivable	35 000	
Inventories	43 000	
Prepaid Expenses	<u>1 000</u>	
		79 000
Fixed Assets		

Delivery Van	10 000	
Land	<u>50 000</u>	<u>60 000</u>
		<b><u>\$139 000</u></b>
<b>Current Liabilities</b>		
Bank overdraft (limit \$12 500)	22 500	
Accounts payable	16,500	39 000
<b>Long Term Liabilities</b>		
Loan		10 000
<b>Proprietorship</b>		
Capital	90 000	
Add Net Profit	<u>10 000</u>	
	100000	
Less Drawing	<u>10 000</u>	<u>90 000</u>
		<b><u>\$139 000</u></b>

### **Additional Information**

1. 30<sup>th</sup> June 2013:
  - a) Sales Cash: 30 000  
Credit: 130 000
  - b) Gross Profit: 50 000
2. 30<sup>th</sup> June 2012:
  - a) Closing inventory: \$35 000
  - b) Accounts receivable: 30 000
3. The business normally allows 30 days credit facility to debtors.
4. The business operates for 300 days in a year.

### **Note:**

Unless or otherwise stated, treat each part of the following questions separate and distinct from one another.

### **Required:**

Using the relevant information, calculate to two decimal places, the following ratios and percentages for 2013. Show formula and full working

- i) Net profit percentage
- ii) Rate of return on Total Assets
- iii) Quick asset ratio
- iv) Stock turnover in number of days
- v) Debt ratio
- vi) Debtors turnover in days

# SYSTEMS FOR IMPLEMENTING THE ACCOUNTING PROCESS



## Strand Outcome

Explore and discuss general principles of internal control and apply knowledge on subsystems for cash.

## Learning Outcomes

- Explore the factors which influences the design of an accounting system and the internal control procedures for its effectiveness.
- Examine the internal control procedures over cash and banking.
- Evaluate the Internal Control procedures over inventory.
- Explore and evaluate the Internal control procedures over Fixed Assets.

STRAND

6

## 6.1 ACCOUNTING SYSTEMS AND INTERNAL CONTROL

### Accounting System

- ✚ set of manual and computerized accounting methods, procedures, and controls established to gather, record, organize, analyze, summarize, interpret, and present accurate and timely financial data for management decisions.

It ensures that all business policies and procedures laid down is carried out diligently.

### Accounting Sub- System

Accounting system divided into different sections.

### Factors affecting the Design of an accounting System

#### **1. Size of the Business**

- affects the number of accounts required to be prepared, also the manner in which records are prepared (handwritten or electronic methods).

#### **2. Owner/ management**

- In which way does the owner wish to receive communication on the progress of the business.
- What type of controls are to be carried out to ensure the stated aims and objectives are accomplished.

#### **3. Ownership of the Business**

- Different types of business ownership determines the different ways of reporting and preparation of reports.

#### **4. Location and Dispersion**

- If the business has many branches than final reports of each branch is prepared separately and later on consolidated as one.

#### **5. Effect of Law**

- The law also influences the type of records a business's needs to prepare and submit.

### Difference between Chart of Accounts and Manual of Accounts

#### **Chart of Accounts**

- is a list of all account titles and numbers arranged according to the classification desired in the ledger e.g Assets, Expenses, Liabilities, Revenue and Capital.



e.g. Assets starts with the number 300, 301, 302 etc

**Example of a Chart of Accounts for a Sole – Proprietor Business**

<b>Assets (200-299)</b>	<b>Expenses (300 – 399)</b>
<b><i>Current Assets</i></b>	300 Purchases
200 Cash in hand	301 Sales Returns
201 Cash at bank	302 Wages
202 Debtors/ Accounts Receivable	303 Insurance
203 Petty Cash Advance/ Imprest	304 Rates
204 Stock/ Inventory	305 Cartage Inwards
205 Income Due	306 Customs duty
206 Prepayments	307 Freight Inwards
<b><i>Fixed Assets</i></b>	308 Cartage Outwards
250 Land	309 Delivery Expanses
251 Building	310 Repairs
252 Furniture	311 General Expenses
253 Plants	312 Stationery
254 Equipment	313 Telephone
255 Motor Vehicle	314 Photocopying
256 Fixtures	315 Interest
<b><i>Investments</i></b>	316 Office Expense
270 Shares in ABC Company	317 Printing
271 Fixed Term Deposit	318 Water Bills
272 Government Bond	319 Accounting Fees
273 Investment	320 Sales Expense
<b><i>Intangibles</i></b>	321 Licence Fees
280 Copyright	322 petty Cash Expenses
281 Patent	323 Advertising

282 Research and Development	324 Salaries
<b>Liabilities (500 – 599)</b>	325 Depreciation
<b>Current Liabilities</b>	326 rent
500 Accounts Payable	327 Electricity
501 Expenses Due	328 Bad Debts
502 Income in Advance	329 Discount Allowed
503 Bank overdraft	330 Bank Charges
<b>Revenues (400 – 499)</b>	331 Miscellaneous Expense
400 Sales	332 Bank Fees
401 Purchase Returns	333 Fuel and Petrol
402 Commission Received	334 Other Expenses
403 Discount Received	
404 Interest Received	<b>Proprietorship (600 – 699)</b>
405 Rent Received	600 Capital
406 Bad Debts Recovered	601 Drawings
407 Doubtful Debts (decrease)	
408 Dividend received	
<b>Long Term Liabilities</b>	
503 Loan	

### Manual of Accounts

- is a complete guide to the accounting system.
- has a set of rules to be followed when preparing any business reports or records e.g. debit and credit rules.



## **Definition of Internal Control**

- is the plan of the organization and all the methods and procedures adopted by management to ensure it operates as planned .

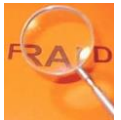
## **Aims/ Purpose of Internal Control**

- safeguard the assets and liabilities of the business.
- check the accuracy and reliability of its accounting data.
- promote operational efficiency.
- encourage adherence to the prescribed management policies.
- prevent fraud and error.

## **Characteristics/ Principles of Internal System**

### **1. Separation of Duties**

- means that one employee should not be responsible for consecutive aspects of a transaction.
- Different employees should be handling different aspects of a given transaction.



### **2. Authorisation**

- means that a person in position of responsibility or authority will validate the a course of action.
- all transactions should require approval by a responsible person

### **3. Responsibility**

- means areas of responsibility should be clearly defined so that an individual officer is accountable for his actions or any query that arises.

### **4. Physical Control**

- are concerned with the custody of assets from theft, misuse or deterioration.

### **5. Reliable Personnel**

- Employees should be qualified and are given duties and responsibilities that commensurate with their abilities/ the personal has capabilities to carry out the duties.

### **6. Sound Accounting Practice**

- The business should maintain complete and accurate accounting record which can be verified by an independent person.

#### 7. Rotation of Duties

- should include rotation of staff duties in key positions occasionally.

#### 8. Verification

- is the act of checking the accuracy of accounting records by some independent means.

#### 9. Serialization of Documents

- All documents should be consecutively numbered .



#### Activity 6.1.1

#### Short Answers

1. Explain what is meant by an accounting system
2. Identify factors that affect the accounting system
3. What is an Internal Control?
4. Differentiate between Chart of accounts and manual accounts
5. Explain three principles of a good internal control system.
6. Why is it crucial to bank the cash takings daily by the business?

## 6.2 SUB SYSTEM CASH

### Internal Controls over Cash



#### Significance of Cash as a Liquid Asset

- ✚ most business transactions involves receiving and paying cash
- ✚ Since cash can be easily stolen and is tempting, adequate control must be implemented to ensure that people with dishonest intentions are detected.

#### Internal Control over Cash Receipts

- ✚ All money received should be evidenced by a document or other proof.
- ✚ All cash received should be **banked intact** at the end of the business day. **Intact** means no payment to be made out of the daily takings. Banking daily ensures that no cash is left in the premises overnight.
- ✚ Provide a receipt. Ideally receipts should be pre-numbered and two-part. One copy should be provided to the payer while the other copy is kept on file. All copies of cancelled or mutilated receipts should be retained in the receipt book for auditing purpose. Unused receipts to be locked away.
- ✚ Employees who receive or handle cash should not be making entries in the accounting records.
- ✚ Keep cash/cheques in a locked and secure area until they can be deposited.
- ✚ Duties should be segregated, meaning that the person recording the receipt should not be the same as that making the deposit. If there are only 2 people in the department, the reconciliation should be performed by the person collecting the receipts.
- ✚ Any refund of cash should be approved by an authorized person.
- ✚ If cash or cheques are received regularly in the mail, two persons should be present when the mail is opened.
- ✚ Cash registers and credit card machines should be balanced daily. Over/short amounts should be monitored.

#### ➡ Internal Control Over Cash Payments

Cash is disbursed to pay expenses and liabilities or to purchase assets.

- ✚ All payments except petty cash should be made by cheque supported by proper invoice/statements received. The paid cheque provides proof of payment.
- ✚ All unused cheques books or forms should be kept in the safe place.
- ✚ Cheques should be prenumbered (easy for reference and identifying lost cheques)
- ✚ To make cheques safer, they should be crossed “Not Negotiable”.
- ✚ all cheques should be properly authorized before the payment is made and preferably two signatories.
- ✚ A regular bank reconciliation should be prepared by a person other than the person receiving or making payments.

Source document for cash receipts	Source document for cash payments
<ul style="list-style-type: none"> <li>+ cash register tape</li> <li>+ cash sales docket</li> <li>+ receipt</li> <li>+ credit side of bank the statement</li> </ul>	<ul style="list-style-type: none"> <li>+ cheque butt</li> <li>+ debit side of the bank statement</li> </ul>

## PETTY CASH IMPREST SYSTEM

- Petty cash procedures represent the use of business cash for minor purchases. Petty cash procedures include setting a fixed petty cash amount for each month, requiring approval prior to spending cash and reconciling the petty cash at least once a month.

### Controls over Petty Cash

- The following are the controls over Petty Cash:
  - + Petty cash fund should be kept in a safe locker.
  - + Petty cash vouchers must be used to record all petty cash expenses, signed by an employee and authorized by a responsible officer.
  - + All petty cash vouchers must be numbered and recorded in a sequence order.
  - + When reimbursing, all paid vouchers should be submitted to the reimbursing cashier for auditing purpose.
  - + Establish a rule to maintain a certain sum for payment only for example a maximum of \$4.00.
  - + An accurate petty cash book should be prepared and checked by a senior officer.
- It is important that the Petty Cash is used only for the purpose for which it was set up and the following should be avoided:
  - + Cash advances for payments. If this is necessary, the advance should be authorized.
  - + Borrowing cash from the petty cash.
  - + Paying wages out of petty cash.
  - + Cash expenditure exceeding the limit set by the Board. For any larger items of expenditure either pay by cheque or draw the cash out of the bank separately. Keep these items separate from the petty cash system.
  - + Open access to the petty cash box. Access to the petty cash box should be restricted, with responsibility for the money being clearly assigned. This is to minimize the risk of errors or unauthorized expenditure occurring.

### **Accounting for Petty Cash Imprest System**

Petty cash system is used to make small payments. An original cheque is drawn, cashed and given to the **petty cashier** who handles payments for small expenses using petty cash voucher.

Cash Payment Journal entry is made for the cheque and debited to the petty cash imprest Account.

**Petty cash voucher** is written by the cashier. The **petty cash book** is prepared from the voucher and balanced. A reimbursement cheque is drawn when the funds in the petty cash becomes low. The reimbursement cheque is the amount of fund used up for expenses.

**NB: Petty cash imprest is classified as a current asset in the balance sheet.**

### **Example of a Petty Cash Voucher**

<b>Petty Cash Voucher</b>			
		<b>Number</b>	
<b>Department</b>		<b>Date</b>	
<b>Amount Requested</b>			
<b>Description of Need</b>			
<b>Requested By</b>			
<b>Approved By</b>		<b>Signature</b>	

The following has been extracted from Shelly's Books. It shows the amount paid to the vouchers during the month of October, 2014

Date	Transactions	Voucher No.	Amount \$
01/10	Advance to Petty Cashier Cheque 502		245.00
01/10	Papers	1	10.00
	Referees	2	30.00
01/10	Postage	3	58.00
02/10	Cakes	4	10.00
03/10	Book M Brown	5	15.00
04/10	Hardware	6	22.00
05/10	Petrol	7	5.00
06/10	Stamps	8	10.00
07/10	Referees	9	30.00
08/10	Milk	10	15.25
31/10	Reimbursement Chq 503		205.25

### Example of a Petty Cash Book

Date	Description	Voucher	Receipts	Payments	Games	Postage	Papers	Sundry
01/10	Petty Cash Fund	Chq 502	245.00					
01/10	Papers	1		10.00			10.00	
	Referees	2		30.00	30.00			
01/10	Postage	3		58.00		58.00		
02/10	Cakes	4		10.00				10.00
03/10	Book M Brown	5		15.00				15.00
04/10	Hardware	6		22.00				22.00
05/10	Petrol	7		5.00				5.00
06/10	Stamps	8		10.00		10.00		
07/10	referees	9		30.00	30.00			
08/10	Milk	10		15.25				15.25
	<b>Total</b>			<b>205.25</b>	<b>60.00</b>	<b>68.00</b>	<b>10.00</b>	<b>67.25</b>
	Balance c/f			39.75				
			245.00	245.00				
31/10	Balance b/f		39.75					
	Reimbursement Chq.No 503		205.25					

### Cash Payments Journal

		Chq No.	Details	Bank
Oct 1	Petty Cash Imprest			245.00
31	Petty Cash Expenses			205.25

	<u>Petty Cash Imprest</u>
Oct 1 Cash	245.00

	<u>Petty Cash Expenses</u>
Oct 31 Cash	205.25





## Activity 6.2.1

### A. Multiple Choice

1. Businesses operate Petty Cash Imprest Systems because this
  - A. Makes payments by cheque easier.
  - B. Makes it easier for the recording of loan repayments.
  - C. Is an effective method of paying minor business expenditures.
  - D. Enables employees to obtain personal loans from the business.
2. The petty cash Imprest is classified in the final accounts as:
  - A. Fixed asset
  - A. Current Asset
  - B. Sundry Expense
  - C. General Expense

### B. Short Answers

3.
  - a. Why do we need to have a petty cash system operating in a business?
  - b. What do you understand by the term imprest system?
  - c. What is the difference between petty cash imprest and petty cash expense?
  - d. What do we call a person who operates a petty cash system?
  - e. What is the source document used for petty cash?
  - f. What do we mean by the term reimbursement?
  - g. Explain the importance of keeping a petty cash imprest system by Firms.
4. State two procedures a firm should employ to improve controls over petty cash.

### C. Calculations

5. In the table below calculate the missing amounts and fill in the blanks

No	Imprest Fund	Expenses	Amount not spent	Reimbursement
1.	\$10.00	5.50	_____	_____
2.	\$20.00	_____	\$3.50	_____
3.	_____	\$8.10	\$6.80	_____
4.	_____	_____	\$5.80	\$24.00
5.	_____	\$37.40	\$13.50	_____
6.	\$30.00	_____	\$6.90	_____
7.	\$120.00	\$67.00	_____	_____

6. The following relates to JK's business. Enter the following transactions in a pretty cash book. Design suitable analysis columns.

2014

Aug	1	Cheque received for petty cash imprest	\$200
	3	Paid stationary \$5; travelling \$12	
	4	Paid courier \$9; cleaning \$22	
	5	Paid travelling \$12; postage \$6	
	10	Paid Postage	\$13
	17	Paid Postage \$8; cleaning \$12	
	21	Paid stationary \$4; postage \$16	
	23	Paid for biscuits, tea and milk	\$13
	28	Paid postage	\$8
	31	Paid cleaning	\$13
		Drew reimbursing cheque	

7. Alia's business uses petty cash imprest system to finance small payments. The following transactions have been extracted from the petty cash vouchers:

Jan	1	Cash cheque for petty cash imprest	\$50
	5	Paid Stamps \$2.10	
	8	Paid for typewriter ribbon	\$1.56
	9	Paid for travelling \$3.10	
	11	Paid Postage	\$2.50
	16	Paid for taxi \$1.50	
	22	Paid stationary \$1.96	
	25	Paid for postage	\$3.00
	29	Paid advertisement \$3.79	
	31	Paid for tea \$2.90	
		Drew reimbursing cheque	

**Required:** Enter the following transactions in a pretty cash book. Design suitable analysis columns.

8.

May 3	Mr Daveta began a petty cash imprest system by using a cheque no 5317 for \$50.00
4	Paid for fares\$4.20, stamps\$0.30, and ruler\$0.40
5	Paid for envelopes \$0.35, taxi fare \$3.00, and rubber \$0.20
7	Paid for photocopying paper \$1.00, stamps \$0.30, and envelopes \$1.00
8	Paid for ballpens \$1.20, twink \$1.00
9	Paid for Office Pins \$0.40, glue \$0.90, and fares \$1.20
10	Paid for telegram \$1.30, taxi fare \$1.80, envelopes \$1.00

11	Paid for typewriter ribbons \$2.50, paper clips \$1.60
12	Received reimbursing cheque for the amount spent

**Required**

a. Record the following in the Petty Cash Book.

b. Show the Cash Payment Journal Entries.

9. J Loga has had a petty cash imprest fund of \$25.00 The book is balanced every Friday. Petty Cash Payments for Jan are as follows:

Jan 4	Paid for advertising \$1.40, freight \$0.90, twink \$1.00
5	Paid for envelopes and freight \$1.20 and \$1.00 respectively
6	Paid for advertising \$1.50 and typing paper \$1.40
7	Paid for stationeries \$1.00 and stamps \$0.30
8	Paid Taxi fare \$1.20, bus fare \$0.70, and pen \$0.60
9	Paid for stamps\$1.50, and erasers \$0.50
10	Paid postage \$1.00, envelope \$0.30, stamps \$0.60 and printing \$0.30

**Required**

a. Record the above in the Petty Cash Book. Design appropriate columns.

## **BANK RECONCILIATION**

### **Purpose of Bank Reconciliation**

- is to check the bank account and the bank statement and reconcile the difference between the two balances.

### **Reasons for Difference in the Bank Account (cash book) and Bank Statement**

1. **Unpresented cheques**- are cheques which are not yet presented to the bank.
2. **Outstanding deposits (Lodgements)** – deposits not recorded in the bank statement but present in the business records.
3. **Standing orders**( means payments made by the bank on behalf of the firm)
4. Direct deposits ( deposits received on behalf of the firm by the bank)
5. Errors
6. Service charges ( bank fees, interest on overdraft, cheque book fees etc).
7. **Dishonored cheques** – a cheque for which the bank refuses to pay for.

### **Steps of doing the Bank Reconciliation Statement**

- 1 a) Compare the **cash receipts journal** with the **Credit side of the Bank Statement** and tick the like items  
  
b) Compare the **cash payments journal** with the **Debit side of the Bank Statement** and tick the like items
2. a) Any amount unticked on the **Credit side of the Bank Statement** apart from **the error** add to the **cash receipts journal** or **Debit side of the Bank Account**  
  
b) Any amount unticked on the **Dedit side of the Bank Statement** apart from **the error** add to the **cash payments journal** or **Credit side of the Bank Account**
3. a) Any item **unticked in the cash receipts journal apart from the error** is known as **Lodgments**, which will **appear in the Bank Reconciliation statement**.  
  
b) Any item **unticked in the cash payments journal apart from the error** is known as **Unpresented Cheque** which will **appear in the Bank Reconciliation statement**
4. Complete the cash receipts journal and cash payments journal or the bank account
5. Prepare the Bank Reconciliation Statement

### **Formulas for preparing Bank Reconciliation Statements**

$$\begin{array}{rclcl} \text{B} & + & \text{L} & - & \text{U} \\ \text{O} & + & \text{U} & - & \text{L} \end{array}$$

B means Bank statement balance (credit or favourable)

O means Bank Statement balance (Debit, overdraft or unfavourable)

L means Lodgements

U means Unpresented Cheques

**NB: Situations where a previous months Bank Reconciliation statement is provided in the question – Check the lodgements with the current Bank Statement Cr side and (Tick). Check the Unpresented cheques with the current Bank Statement Dr side and (tick). If the amounts do not match then the lodgements and unpresented cheques will reappear in the current months BRS.**

### **Correction of Errors Over addition and Under addition**

#### **Cash payments Journal**

1. If the cash payments journal is **over added** the adjustment of the error is adjusted in the **cash Receipts journal or debit side of the Bank Account**
2. If the cash payments journal is **under added** the adjustment of the error is adjusted in the **cash Payments journal or credit side of the Bank Account**

#### **Cash Receipts Journal**

1. If the cash receipts journal is **over added** the adjustment of the error is adjusted in the **cash Payments journal or credit side of the Bank Account**
2. If the cash receipts journal is **under added** the adjustment of the error is adjusted in the cash Receipts journal or debit side of the Bank Account

#### **Errors made by the Bank**

If errors are made by the bank all adjustments will be made in the bank reconciliation statement.

#### **Errors in deposits made by the Bank**

	<u>Cash Book</u>
Sales	\$220
Sales	\$64

#### **Bank Statement Errors**

Particulars	Debit	Credit	Balance
Deposit		240 E1	
Deposit		58 E2	
			<b>Errors</b>

#### **Procedure**

- a) If BLU is used in Bank Reconciliation Statement **Less** the Bank Error amount \$20 for E1 and **add** the bank error amount \$6 for E2.
- b) If OUL is used in Bank Reconciliation Statement **add** the Bank Error amount \$20 for E1 and **Less** the bank error amount \$6 for E2.

## Errors in payments made by the Bank

### Cash Book

Chq 101	\$72
Chq 104	\$87

### Bank Statement Errors

Particulars	Debit	Credit	Balance
Chq 101	82 E3		
Chq 104	80 E4		
<b>Errors</b>			

- a) If BLU is used in Bank Reconciliation Statement **Add** the Bank Error amount \$10 for E1 and **less** the bank error amount \$7 for E2.
- b) If OUL is used in Bank Reconciliation Statement **less** the Bank Error amount \$10 for E1 and **add** the bank error amount \$7 for E2.

### Example:

The following information relates to Riha Patel's cash book for the month of May 2014.

Cash at bank balance – 1/5/14 is \$500Dr

Cash Payments Journal				Cash Receipts Journal		
Date	Particulars	Cheque Number	Amount \$	Date	Particulars	Amount \$
May 16	Wages	318	200	May 20	Fees	200
20	A. Brown	319	175	22	W. Wah	490
	A. Reena	320	145			
21	Electricity	321	200	25	Fees	225
30	Purchases materials	322	150	28	K.Roneel	220
31	C. Maxwell Ltd	323	140	31	Fees	445

Assume : Bank has correct records

### Bank Statement

Date	Particulars	Debit	Credit	Balance
May 26	Balance			\$500 Cr
27	Deposit		200	700 Cr
28	Deposit		490	1190 Cr
28	Chq 318	200		990 Cr
28	Chq 319	170		820 Cr
29	Deposit		225	1045 Cr
30	Bank fees	2.00		1043 Cr
30	Deposit		220	1263 Cr
31	Chq 322	150		1113 Cr
31	Dish Chq	490		623 Cr
31	Direct Dep -Jess		300	923 Cr

### Required:

- a) Prepare the cash journals
- b) Prepare the bank account
- c) Prepare the bank Reconciliation Statement

### Solution

Cash receipts Journal			Cash payments Journal		
Date	Particulars	Amount \$	Date	Particulars	Amount \$
May 31	Total receipts	1580	May 31	Total payments	1010
	D. Deposit - Jess	300		Bank Fees	2
	Er - Chq 319	5		Dish. Cheque	490
		<b><u>\$1885</u></b>			<b><u>\$1502</u></b>

### Bank Account

Date	Particulars	Amount	Date	Particulars	Amount
May 1	Balance	\$500	May 31	Total payments	1502
31	Total Receipts	1885		Balance c/d	883
		<b>\$2385</b>			<b>\$2385</b>
June 1	Balance b/f	883			

### Bank Reconciliation Statement

	\$	\$
Balance as per bank statement		923 Cr
Add lodgments not yet credited		445
		1363
Less Unpresented Cheques:	<b><u>Cheque No.</u></b>	<b><u>Amount</u></b>
	320	145
	321	200
	322	140
		485
<b>Balance as per Bank Account</b>		<b>883 Dr</b>



#### Activity 6.2.2

#### A. Multiple Choice

1. A business's bank statement shows a credit balance of \$2500, with unpresented cheques of \$2000 and lodgment not credited of \$130. What would be its cash at bank account balance?

- A. \$630 debit
- B. \$630 credit
- C. \$4370 credit
- D. \$4370 debit



2. A bank statement shows a favourable balance of \$400. Cash at bank amounted to \$800Dr while unpresented cheques amounted to \$200. Therefore, the lodgment not credited appearing in BRS should be:

- A. \$400
- B. \$800
- C. \$600
- D. \$1200

3. A cash at bank ledger account at the end of the month shows a balance of \$200Cr. Cheques outstanding amounted to \$200 and lodgments not credited were \$150. The bank statement balance should be:

- A. \$150 credit
- B. \$150 debit
- C. \$450 credit
- D. \$450 debit

4. If the existing bank statement balance was debit, a deposit not yet credited would be:

- A. added to the bank Account
- B. deducted from the bank statement
- C. added to the cash receipts journal
- D. added to the cash payments journal as an error

5. Sales, a debtor directly credited his payment to the bank. This item in the bank statement would be:

- A. added to cash payments journal
- B. deducted in the bank statement
- C. debited to the bank account
- D. added to the debtors Account

## B. Accounting Procedure

1. Kesaia provides the following information for her bank account:

Cash payments Journal				Cash Receipts Journal		
Date	Particulars	Cheque Number	Amount	Date	Particulars	Amount \$
<b>2014</b>				2014		
<b>Dec 26</b>	Wages	718	600	Dec 27	Fees	<b>200</b>
<b>27</b>	A. Brown	719	350			
	A. Sydney	720	290	28	M. Jazz	<b>780</b>
<b>28</b>	Stationery	721	400	29	Fees	<b>450</b>
<b>30</b>	Purchases, materials	722	300	30	M. Tad	<b>440</b>
<b>31</b>	<b>C. Maxwell Ltd</b>	<b>723</b>	<b>280</b>	<b>31</b>	<b>Fees</b>	<b>890</b>

Opening balance as per bank account is \$1000 DR

Bank Statement				
Date	Particulars	Debit \$	Credit \$	Balance \$
<b>Dec 26</b>	Balance			<b>1000Cr</b>
<b>27</b>	Deposit		200	<b>1200 Cr</b>
<b>28</b>	Deposit		780	<b>1980 Cr</b>
<b>28</b>	Chq 718	600		<b>1380 Cr</b>
<b>28</b>	Chq 719	350		<b>1030 Cr</b>
<b>29</b>	Deposit		450	<b>1480 Cr</b>
<b>30</b>	Bank fees	4.00		<b>1476 Cr</b>
<b>30</b>	Deposit		440	<b>1916 Cr</b>
<b>31</b>	Chq 722	300		<b>1616 Cr</b>
<b>31</b>	<b>Dish Chq</b>	<b>780</b>		<b>836 Cr</b>

### Required:

- Prepare the cash journals
- Prepare the bank account
- Prepare the bank Reconciliation Statement

2. Demi Smith operates the 24 Hour Typing Service and she is having difficulty reconciling her cash records with her Bank Statement.

**Bank Reconciliation Statement of Demi Smith  
as at 31st August 2014**

		\$	\$
Balance as per Bank Statement			1460Cr
Add Deposits Not Credited			<u>420</u>
			1880
Less Unpresented Cheques	<b>Cheque No</b>	<b>Amount</b>	
	566	700	
	596	<u>1100</u>	1800
<b>Balance as per Bank Account</b>			<b><u>80DR</u></b>

**Cash Receipts Journal**

Date	Particulars	Amount
<b>Sept 2</b>	P. Priya	<b>780.00</b>
<b>4</b>	Fees	<b>1500.00</b>
<b>8</b>	Fees	<b>2100.00</b>
<b>12</b>	A. Lynch	<b>290.00 E</b>
<b>16</b>	Fees	<b>1700.00</b>
<b>17</b>	G. Pert	<b>450.00</b>
<b>19</b>	Fees	<b>2440.00</b>
<b>22</b>	Fees	<b>1890.00</b>
<b>24</b>	P. Broderick	<b>1560.00</b>
<b>26</b>	Fees	<b>2800.00</b>
<b>30</b>	<b>R. Osborne</b>	<b>380.00</b>

**Cash Payments Journal**

Date	Particulars	Cheque number	Amount \$
<b>Sept 2</b>	I. Patel	597	<b>540.00 E</b>
<b>7</b>	Postage	598	<b>55.00</b>
<b>12</b>	Wages	599	<b>1050.00</b>
<b>15</b>	H. Heena	600	<b>1200.00E</b>
<b>20</b>	A. Phipps	601	<b>800.00</b>

<b>21</b>	Delivery	602	<b>100.00</b>
<b>24</b>	K. Kumar	603	<b>1975.00</b>
<b>25</b>	Wages	604	<b>1050.00</b>
	Drawings	605	<b>450.00</b>
<b>26</b>	H. Sonam	606	<b>1350.00</b>
<b>30</b>	<b>Philipson Ltd</b>	<b>607</b>	<b>1365.00</b>

### Bank Statement

Date	Particulars	Debit	Credit	Balance
<b>Sept 1</b>	Balance			<b>1460Cr</b>
<b>1</b>	Deposit		420.00	<b>1880.00</b>
<b>2</b>	Deposit		780.00	<b>2660.00</b>
<b>4</b>	Deposit		1500.00	<b>4160.00</b>
<b>8</b>	Deposit		2100.00	<b>6260.00</b>
	Chq 597	560.00		<b>5700.00</b>
<b>11</b>	Chq 598	55.00		<b>5645.00</b>
<b>12</b>	Deposit		300.00	<b>5945.00</b>
	Chq 599	1050.00		<b>4895.00</b>
<b>13</b>	Chq 596	1100.00		<b>3795.00</b>
<b>16</b>	Deposit		1700.00	<b>5495.00</b>
<b>17</b>	Deposit		450.00	<b>5945.00</b>
	600	1170.00		<b>4775.00</b>
	Chq Book	20.00		<b>4755.00</b>
<b>19</b>	Deposit		2440.00	<b>7195.00</b>
<b>22</b>	Deposit		1890.00	<b>9085.00</b>
	Chq 601	800.00		<b>8285.00</b>
<b>24</b>	Deposit		1560.00	<b>9845.00</b>
	Chq 602	100.00		<b>9745.00</b>

<b>25</b>	Chq 604	1050.00	<b>8695.00</b>
<b>26</b>	Deposit	2800.00	<b>11495.00</b>
<b>30</b>	Chq 606	1350.00	<b>10145.00</b>
30	Chq 666	700.00	<b>9445.00Cr</b>

Assume the Bank Statement is correct

From the information given above you **are required** to:

- a) Prepare the bank account
- b) Prepare the Bank Reconciliation Statement as at 30<sup>th</sup> September 2014.

3. Sharma's bank account at 31<sup>st</sup> December 2014 showed a credit balance of \$9620.50. After a comparison with the Bank Statement which had an unfavourable balance of \$9190.18, the following differences were found.

Dec 10 Sera's cheque was dishonoured valued \$116  
Interest on Mortgage \$64  
Bank fees \$10  
Interest on debenture received \$216  
Unpresented cheques Chq No 101, \$764 and Chq No 102, \$125  
Deposit not yet credited amounted to \$120  
Total cash receipts \$20062.47  
Total cash payments \$20427.15

**Required:**

- a) Prepare the cash at bank account.
- b) Prepare the Bank Reconciliation Statement as at 31<sup>st</sup> December 2014.

4. Shiva's bank statement as at 30<sup>th</sup> September, 2014 showed a credit balance of \$1782.24. The cash at bank balance at 1<sup>st</sup> September, 2013 was \$1771 Dr.

The following differences were found:-

- The accounts clerk has over added on the payments side by \$30.
- Direct debit for car loan \$495.
- Deposits not credited by the bank \$264.18.



## 6.3 SUB- SYSTEM - INVENTORY

### Inventory

- ➡ **Inventory** or **stock, merchandise** refers to the goods and materials that a business holds for the ultimate purpose of resale.
- ➡ Inventory is often the largest item in the current assets category, and must be accurately counted and valued at the end of each accounting period to determine a business's profit or loss.

### **Classification of Inventories by Different Businesses**

<b>Business</b>	<b>Inventories</b>
<b>Retail store</b>	<b>Foodstuffs, clothing, hardware, electrical, sporting goods, groceries</b>
<b>Furniture wholesaler</b>	<b>Furniture</b>
<b>Electrical retailer</b>	<b>Electrical goods</b>
<b>Car dealer</b>	<b>Motor vehicles</b>
<b>Animal Farmer</b>	<b>Sheep , cattle, horses, pigs, goats, chickens</b>
<b>Mining company</b>	<b>Coal , iron, ore, silver</b>

### Importance of Inventories

- Assists in profit determination (calculation of gross profit).
- Closing stock has to be identified for the preparation of the Final Accounts.
- Large amounts of money are invested in inventories therefore sufficient control is required. (CCTV cameras, inspection of shopping bags, curved mirrors, store detectives).

### **Drawbacks of overstocking (too much stock)**

- ✚ Inventories can become out dated.
- ✚ Excessive stock requires a large storage area (additional cost e.g rent, storage space, insurance etc).
- ✚ It may cause the problems of converting stocks into cash.

### **Drawbacks of understocking inventory**

- ✚ Sales will be lost to competitors.
- ✚ Goodwill will diminish (reputation of the business will go down).

## Control over the Purchase of Inventories

1. **Ordering inventories** (each department keeps a record of stock sold. When the stock comes at a minimum level it is ordered again).
  - + **Purchase Requisition** is an internal document used to order the goods required by that department and is sent to the purchases department.



- + **Purchase department** is responsible for buying goods irrespective of which department has ordered it.
  - + **Order Form** is sent to the supplier ordering the goods.
2. **Receiving inventories** (all inventories should be received by the receiving department).
    - + All inventories should be checked against order slip or the packaging slip.

### **Functions of Department in purchasing Inventories**

<b><i>Purchasing Department</i></b>	<b><i>Receiving Department</i></b>	<b><i>Inventory Storage Department</i></b>	<b><i>Accounting Department</i></b>
- contacts suppliers	- physically handles the receiving of inventories	- physically stores all inventories	- checks suppliers invoice with order forms and goods
- completes order form for the purchase of inventories	- checks incoming inventories with order forms	- receives inventories accompanied by a goods received slip	- checks suppliers credit notes with the debit notes
- receive slip from receiving department	- completes goods received slip and notifies purchasing dept that inventories have arrived		- prepares purchases journal and purchase returns journals
- notifies the selling department that goods have been received	- forwards invoices to accounting departments		
- authorizes debit	- sends goods to		



notes and forwards it to the supplier when inventories are to be returned	inventory storage department ready for distribution.  -Returns goods to the supplier when needed.		
---	---	--	--

### **Control over sale of inventories**

- + **Standardised order form** (when order is received in writing or over phone it is written in internal order form).
- + **Inventory Requisition** (a form used for requesting inventories from the storage department).
- + **Despatch or Delivery docket** (document signed by the customer to certify the receipt of the inventories).
- + **Invoice** (document usually accompanies the inventories and is the customers record of goods received).
- + **Credit note** (document used when customers return goods).

<b>Sales Department</b>	<b>Credit Department</b>	<b>Inventory Storage Dept</b>	<b>Despatch Department</b>	<b>Accounting Department</b>
- receives orders from the customers	- checks the customer's creditworthiness	- physically stores all inventories	- delivers inventories to customers	- receives duplicate invoices and credit notes
- completes standard order forms	- advises selling dept if credit is granted or refused	- releases inventories only on the basis of an inventories requisition	- receives despatch docket with all inventories	- prepares sales journal and sales returns journal
- prepares invoice, inventory requisition and dispatch docket  - checks with credit dept as to customers credit worthiness		-receives returned inventories via the receiving dept, accompanied by goods received slip	- retains despatch docket signed by customer as proof of delivery	

## **Control over stored inventories**

**Location** -stored where they are easily accessible by those authorities.

**Security** -ensure adequate security is maintained.

**Turnover** -should be sold as fast as possible.

## **Stocktaking**

✚ is the process of listing, counting and valuing unsold inventories on hand.

## **Importance of Stocktaking**

- ✚ Determine the value of inventories on hand at a particular date.
- ✚ Is the only way of determining actual inventory on hand, see whether stock has been lost through theft or spoilage.

## **Source Documents associated Purchase and Sales of Inventories**

<b>Transaction</b>	<b>Source Document</b>
Credit purchase of inventories	Tax invoice received
Credit sales of inventories	Tax invoice issued
Purchase returns	Credit note received
Sales returns	Credit note issued

## **System used to account for Inventories**

### **Physical/Periodic Inventory System**

- ✚ Where stock is physically counted, listed and valued at the end of each year. (Stocktaking).
- ✚ Is adopted by business which finds it impossible to keep a record of the cost price of all inventories sold.
- ✚ It does not require a continuous record of inventory balances after each transaction.
- ✚ In this case everything that is not on hand at the end of the period is assumed to be sold whereas in reality it may be not because of theft, pilferage, breakage or theft.

### **Advantages of Periodic Inventory system**

- + provides full check against the perpetual inventory system to verify discrepancies and value stock more accurately
- + is simple and easy to adopt
- + used for low value and high turnover items

### **Disadvantages of Periodic Inventory system**

- + Is time- consuming and brings disturbances to normal business work.
- + When closing stock figure is obtained by physical count, there is danger of discrepancies arising from pilferage, waste, deterioration, theft and clerical errors are not detected.
- + Short term interim reports cannot be prepared frequently because the amount of closing stock are not available at all times.

### **Perpetual Inventory System**

- + Provides continuous record of purchase and sales showing current balances of cost of goods sold and stock on hand.

### **Advantages of Perpetual Inventory System**

- + Stock on hand can be determined at any point in time without actual stock taking.
- + Is most useful for interim reporting purposes and stock control.
- + stock loss can be identified when used in conjunction with the physical method
- + Is used for high value and low turnover items.
- + Allows much greater control over inventories.

### **Disadvantages of Perpetual Inventory System**

- + May be costly to maintain especially when the inventory includes numerous items of small value.
- + Involves too much clerical work and is time consuming.
- + May not reveal inconsistencies unless compared with physical stock take.

## Difference between Periodic and Perpetual Inventory System

	<b>Perpetual Inventory System</b>	<b>Periodic Inventory System</b>
1	Stock on hand can be identified from stock ledger cards	Stock on hand can be determined by stock- take
2	Purchase of inventory is treated as asset	Purchase of inventory is treated as expense
3	Stock loss is identified when compared with periodic system	Stock loss cannot be identified under this system
4	Interim and profit report can be prepared regularly because stock on hand and COGS can be found anytime	The reports cannot be prepared regularly because required data is not available
5	Used for high unit cost and low turnover items e.g. cars, televisions, jewelleryes, sofa set, furniture	Used for low unit cost and high turnover items groceries, food items, vegetables

### **Effect of Incorrect stock valuation**

#### **Closing Stock Overstated**

<b><i>Details</i></b>	<b><i>Effect on Year 1</i></b>	<b><i>Effect on Year 2</i></b>
<b>Cost of goods sold</b>	Understated	<b>Overstated</b>
<b>Gross and Net Profit</b>	Overstated	<b>Understated</b>
<b>Current Assets</b>	Overstated	<b>No Effect</b>
<b>Owner's Equity</b>	Overstated	No effect

#### **Closing Stock Understated**

<b><i>Details</i></b>	<b><i>Effect on Year 1</i></b>	<b><i>Effect on Year 2</i></b>
<b>Cost of goods sold</b>	Overstated	Understated
<b>Gross and Net Profit</b>	Understated	Overstated
<b>Current Assets</b>	Understated	No Effect
<b>Owner's Equity</b>	Understated	No effect

## **Methods of Inventory Valuation**

### **➡ FIFO (First In First Out) Method**

- assumes that goods purchased first are the goods sold first.
- Closing stock is always valued at the most recent price.
- in times of rising prices FIFO over values closing stock, undervalues cost of goods sold and overvaluing profits.
- used for items which are perishable or have frequent style changes or technology changes .

<b>Advantages</b>	<b>Disadvantages</b>
Is acceptable to Fiji Revenue and Customs Authority (FRCA).	Not suitable in times of rising prices because businesses have to pay more tax.
Closing stock in the balance sheet is valued nearest to market price.	In times of rising prices it fails to give realistic values of cost of goods sold.
The oldest items are sold first.	
Permitted by Accounting standards as an acceptable approach to inventory valuation.	

### **Example**

Daven and Company sells saffron dresses. The following transactions took place during the month.

- June 1 Balance 10 dress at \$20 each
- 8 Purchases 15 dress at \$8 each
- 10 Sold 12 dresses
- 19 Purchased 25 dresses at \$10 each
- 22 Sold 15 dresses
- 26 Purchased 35 dresses at \$9 each
- 30 Sold 20 dresses

### **Required**

- Prepare the Stock Leger card using the FIFO method under perpetual system.
- Calculate the total amount of purchases.

- c) Calculate the cost of goods sold.
- d) Calculate the gross profit or loss made if the selling price of the dress is \$15 each.
- e) Calculate the amount of closing stock .
- f) If the physical ending inventory count revealed \$258, calculate the amount of theft.

### Solution

a)

Item : Dress										
Method: FIFO					Re- Order Level :35					
		Receipt/ In			Issued/ Out			Balance		
<i>Date</i>	<i>Particulars</i>	<i>Qty</i>	<i>Price</i>	<i>Total</i>	<i>Qty</i>	<i>Price</i>	<i>Total</i>	<i>Qty</i>	<i>Price</i>	<i>Total</i>
1	Balance							10	20	200
8	Purchases	15	8	120				15	8	120
10	Sales				10	20	200			
					2	8	16	13	8	104
19	Purchases	25	10	250				25	10	250
22	Sales				13	8	104			
					2	10	20	23	10	230
26	Purchases	35	9	315				35	9	315
30	Sales				20	10	200	3	10	30
								35	9	315

b) Total purchases = (\$120 + 250 + 315)

$$= \$685$$

c) Cost of goods sold = calculate the total amount in total of Out column apart from any purchases returns.

$$\text{Cost of Goods Sold} = (\$200 + 16 + 104 + 20 + 200)$$

$$= \$540$$

d)Gross profit = sales – Cost of goods sold

$$= (47 \times 15) - \$540$$

$$= \$165$$

e) Closing stock = the amount remaining in the total of out column after the last sale  
 = \$ 345

f) **Stock loss/ theft/ shoplifting** = Actual closing stock on hand from stock ledger card  
 – Physical count ending stock

= \$345 - \$258

= \$87



### Activity 6.3.1

1. The following is the information about Miss Miriama's inventory shop

Date	Particulars	
Dec 1	Balance	350 units @ \$2 per unit
4	Sold	150 units
7	Sold	100 units
10	Purchased	150 units @ \$2.40 per unit
12	Sold	100 units
21	Purchased	70 units @ \$2.30 per unit
29	Sold	110 units

#### **Required:**

a) Prepare the stock ledger ledger card using FIFO method.

b) Calculate the amount of cost of goods sold.

c) Calculate the amount of closing stock.

2. The following transactions relates to SD Enterprise.

Date	Particulars	
Jan 1	Balance	120 units @ \$4 per unit
4	Bought	200 units @ \$3.90 per unit

5	Sold	150 units @ \$6 per unit
15	Sold	80 units @ \$6.20 per unit
21	Bought	100 units @ \$4.10 per unit
22	Bought	200 units @ \$4.15 per unit
24	Sold	250 units @ \$7 per unit
28	Sold	100 units @ \$6.50 per unit

**Required:**

- Prepare stock ledger card using FIFO method.
- Calculate the total sales.
- Calculate the amount of cost of goods sold.
- Prepare the Trading account to calculate the gross profit or loss.
- List down two advantages of FIFO method.

3. Chands Enterprise is involved in buying and selling of handbags. The transactions relating to his business were as follows:

Date	Particulars
<b>July 4</b>	<b>Purchased 25 bags at \$18 each from Suva suppliers</b>
<b>10</b>	<b>Sold 14 bags for cash</b>
<b>August 11</b>	<b>Purchased 10 bags at \$20 each for cash</b>
<b>14</b>	<b>Sold 15 bags on account to Tomasi and Sons</b>
<b>18</b>	<b>Purchased 30 bags at \$19 each from Prasad</b>
<b>Sept 21</b>	<b>Purchased 16 bags at \$16 each for cash</b>
<b>Dec 22</b>	<b>Sold 36 bags to Fong Lee</b>
<b>31</b>	<b>Fong returned 4 damaged bags</b>

**Required:**

- Prepare the stock ledger card using the FIFO Method.
- Calculate the value of total purchases.



c) Calculate the value of cost of goods sold.

d) Calculate the value of closing stock.

e) If the physical revealed \$160 worth of closing stock, calculate the amount for shoplifting.

## **2. LIFO (Last in First Out) Method**

- assumes that goods bought at the end will be sold first (most recently acquired goods are sold first).

- it leaves the oldest items in closing stock.

- in times of rising prices it tends to under value closing stock, over- value cost of goods sold, under value profits.

<b>Advantages</b>	<b>Disadvantages</b>
in times of rising prices it shows a smaller profit, resulting in less income tax paid.	Not permitted as a stock valuation method under financial reporting standard.
is best suited for the income statement because it matches current cost against current sales .	the stock in the balance sheet is recorded at the outdated price therefore unrealistic.
	during inflation stock on hand is undervalued in real terms resulting in working capital and current ratio to be understated.

**Example :** Daven and Company sells saffron dresses. The following transactions took place during the month.

June 1 Balance 10 dress at \$20 each

8 Purchases 15 dress at \$8 each

10 Sold 12 dresses

19 Purchased 25 dresses at \$10 each

22 Sold 15 dresses

26 Purchased 35 dresses at \$9 each

30 Sold 20 dresses

**Required :**

- a) Prepare the Stock Ledger card using the LIFO method under perpetual system .
- b) Calculate the total amount of purchases.
- c) Calculate the cost of goods sold.
- d) Calculate the gross profit or loss made if the selling price of the dress is \$15 each.
- e) Calculate the amount of closing stock.
- f) If the physical ending inventory count revealed \$440, calculate the amount of theft.
- a)

Item : Dress		Method: LIFO								
		Receipt/ In			Issued/ Out			Balance		
<i>Date</i>	<i>Particulars</i>	<i>Qty</i>	<i>Price</i>	<i>Total</i>	<i>Qty</i>	<i>Price</i>	<i>Total</i>	<i>Qty</i>	<i>Price</i>	<i>Total</i>
1	Balance							10	20	200
8	Purchases	15	8	120				15	8	120
10	Sales				12	8	96	10	20	200
								3	8	24
19	Purchases	25	10	250				25	10	250
22	Sales				15	10	150	10	20	200
								3	8	24
								10	10	100
26	Purchases	35	9	315				35	9	315
30	Sales				20	9	180	10	20	200
								3	8	24
								10	10	100
								15	9	135

b) Total Purchases = 120 + 250 + 315

**= \$685**

c) Cost of goods sold = 96 + 150 + 180

**= \$426**

d) Gross profit =  $(\$15 \times 47) - 426$

= **\$279**

e) Closing stock =  $\$200 + 24 + 100 + 135$

= **\$459**

f) Stock loss/ theft/ shoplifting =  $\$459 - 440$

= **\$19**



### Activity 6.3.2

1. The following is obtained from De Anna about a particular item of inventory

August 1 Balance 220 units at \$4 per unit

6 Purchased 100 units at \$5 per unit

10 Sold 120 units at \$8 per unit

15 Sold 10 units at \$6 per unit

18 Purchased 70 units at \$3 per unit

21 Purchased 20 units at \$7 per unit

23 Sold 95 units at \$10 per unit

26 Purchased 56 units at \$5 per unit

30 Sold 25 units at \$10 per unit

#### Required:

- Prepare the stock ledger card using LIFO Perpetual Method.
- calculate the total value of cost of goods sold.
- Calculate the gross profit under the LIFO method.
- what is the value of the closing stock under LIFO method.

### 3. WAC (Weighted Average Cost)

- ✚ It calculates a new average cost every time inventory is bought.
- ✚ It is suitable for manufacturing enterprises where several steps are involved e.g. petrol.

#### Formula:

$$\text{Weighted Average Cost} = \frac{\text{Cost of Goods Available for Sale}}{\text{No. of Units Available for sale.}}$$

Per Unit

Advantages	Disadvantages
It evens out price fluctuations where there are constant changes in price prices therefore giving better results than LIFO and FIFO.	A calculation in this method becomes complicated when there are numerous purchases.
Is less complicated than LIFO and FIFO.	
Is acceptable by FRCA.	
Permitted as a stock valuation method under financial reporting standards.	

**Example:** Daven and Company sells saffron dresses. The following transactions took place during the month.

June 1 Balance 10 dress at \$20 each

8 Purchases 15 dress at \$8 each

10 Sold 12 dresses

19 Purchased 25 dresses at \$10 each

22 Sold 15 dresses

26 Purchased 35 dresses at \$9 each

30 Sold 20 dresses

### **Required**

- a) Prepare the Stock Ledger card using the WAC method under perpetual system.
- b) Calculate the total amount of purchases.
- c) Calculate the cost of goods sold.
- d) Calculate the gross profit or loss made if the selling price of the dress is \$15 each.
- e) Calculate the amount of closing stock.

### **Solution**

Item : Dress					Method: WAC					
		Receipt/ In			Issued/ Out			Balance		
<i>Date</i>	<i>Particulars</i>	<i>Qty</i>	<i>Price</i>	<i>Total</i>	<i>Qty</i>	<i>Price</i>	<i>Total</i>	<i>Qty</i>	<i>Price</i>	<i>Total</i>
June 1	Balance							10	20	200
8	Purchases	15	8	120				25	12.8	320
10	Sales				12	12.8	153.6	13	12.8	166.4
19	Purchases	25	10	250				38	10.96	416.48
22	Sales				15	10.96	164.40	23	10.96	252.08
26	Purchases	35	9	315				58	9.78	567.08
30	Sales				20	9.78	195.60	38	9.78	371.64

b) Total purchases = (\$120+ 250 +315)

$$= \textbf{\$685}$$

c) COGS = 153.6 + 164.40 + 195.60 = **\$ 513.6**

d)Gross profit = sales – Cost of goods sold

$$= \$705 - \$513.6$$

$$= \textbf{\$191.40}$$

e) Closing stock = the amount remaining in the total of out column after the last sale

$$= \textbf{\$371.64}$$



### Activity 6.3.3

## Filling Stock Card

1. Sneha's Furniture shop uses perpetual inventory system to record inventory movements. Given below is the stock card for the business.

Item : Table										
		Receipt/ In			Issued/ Out			Balance		
<i>Date</i>	<i>Particulars</i>	<i>Qty</i>	<i>Price</i>	<i>Total</i>	<i>Qty</i>	<i>Price</i>	<i>Total</i>	<i>Qty</i>	<i>Price</i>	<i>Total</i>
Jan 1	Balance							2	\$550	1100
3	Purchases	3	\$600	\$1800				5	580	2900
4	Purchases	3	420	1260				8	520	4160
7	Sales				4	520	2080	4	520	2080
11	Purchases	2	550	1100				-	-	-
	Sales				2	-	-	-	-	-

### Required:

- State the method of inventory valuation used
  - Complete the stock ledger card.
  - Calculate the gross profit if the selling price per table was \$850.
2. From the following information prepare the stock ledger card using the WAC method

April 1 Stock 500kg @ \$3.00

6 Purchases 300kg @ \$2.50

14 Sales 600kg

18 Purchases 200kg @ \$3.50

20 Sales 300kg

25 Purchases 400kg @ \$2.50

3. The following transactions relate to Lal's Saree House

Feb 8 Bought 136 saris at total cost of \$680

10 Sold 80 saris for cash

11 Sold 30 saris to Meri

18 Bought 130 at \$5.10 each from Meme

20 Sold 120 saris for cash

24 Bought 132 saris at a total cost of \$693 for cash

28 Sold 108 saris to Mela

***A physical stock take revealed that there was \$286 worth of saris on hand***

**Required:**

a) Prepare the stock ledger from the above information using the FIFO, LIFO, WAC method.

**4. SI (Standard Identification/Cost)**

- requires the actual cost of each item from specific purchases which is used to determine the value of stock on hand.

- is used for items that are rare, expensive or unique e.g. antiques, automobiles, real estates.

Advantages	Disadvantages
- Is used in the purchase and sale of high-priced articles, which is readily identifiable.	-management is able to manipulate by selling at different prices at different points of time.
	Cannot be used for inventory items which are large in quantity with low value such as grocery, kerosene.

**Example**

Jaya owns and operates a Shop dealing with the sales of Gold Bracelets. On 1 July she had the following stock:

10 Bracelets at \$1000 each

7 Bracelets at \$1200 each

During the month the following transactions took place:

July 2 Sold two Bracelets cost price \$1000 for \$1600 cash.

4 Purchased four Bracelets for \$1200 on credit.

11 Jaya took one Bracelets cost price \$1200 for her own use.

20 Sold three Bracelets cost price \$1000 to \$2400.

25 Sold one Bracelet cost price \$1000 for cash \$1800.

### **Required**

Use the information given above to prepare the stock ledger card using Standard Identification cost method

<b>Item : Watches Method : Standard Identification</b>										
		<b>Receipt/ In</b>			<b>Issued/ Out</b>			<b>Balance</b>		
<b>Date</b>	<b>Particulars</b>	<b>Qty</b>	<b>Price</b>	<b>Total</b>	<b>Qty</b>	<b>Price</b>	<b>Total</b>	<b>Qty</b>	<b>Price</b>	<b>Total</b>
<b>July 1</b>	<b>Balance</b>							<b>10</b>	<b>1000</b>	<b>10000</b>
								<b>7</b>	<b>1200</b>	<b>8400</b>
<b>2</b>	<b>Sales</b>				<b>2</b>	<b>1000</b>	<b>2000</b>	<b>8</b>	<b>1000</b>	<b>8000</b>
								<b>7</b>	<b>1200</b>	<b>8400</b>
<b>4</b>	<b>Purchases</b>	<b>4</b>	<b>1200</b>	<b>4800</b>				<b>8</b>	<b>1000</b>	<b>8000</b>
								<b>11</b>	<b>1200</b>	<b>13200</b>
<b>11</b>	<b>Drawings</b>				<b>1</b>	<b>1200</b>	<b>1200</b>	<b>8</b>	<b>1000</b>	<b>8000</b>
								<b>10</b>	<b>1200</b>	<b>12000</b>
<b>20</b>	<b>Sales</b>				<b>3</b>	<b>1000</b>	<b>3000</b>	<b>5</b>	<b>1000</b>	<b>5000</b>
								<b>10</b>	<b>1200</b>	<b>12000</b>
					<b>1</b>	<b>1000</b>	<b>1000</b>	<b>4</b>	<b>1000</b>	<b>4000</b>
								<b>10</b>	<b>1200</b>	<b>12000</b>



### Additional Questions: 6.3.4

1. Accounting for inventory is crucial because
  - A. Inventory depletes easily
  - B. Inventory is a liability to the business
  - C. Inventory represents major cash investment for the firm
  - D. Inventory takes time to replace.
2. If the closing inventory of a business is overstated, then the
  - A. Assets will be understated
  - B. Liabilities will be overstated
  - C. Net profit will be understated
  - D. Gross profit will be overstated
3. In times of rising price levels, the inventory valuation which reflects the higher net profit figure is
  - A. FIFO
  - B. LIFO
  - C. WAC
  - D. SI
4. Under which method of inventory valuation does purchase of inventory is recorded as an asset?
  - A. Physical stock taking
  - B. Inventory valuation method
  - C. Perpetual inventory system
  - D. Periodic inventory system
5. The following transactions relate to tyres sold by Inoke. At 1<sup>st</sup> Feb 2015 there were 6 tyres at \$500 in stock. The following transactions took place during the month.

Feb 3 Purchased 10 Tyres at \$550 order No. 40

8 Sold 4 tyres from original stock

14 Purchased 6 Tyres at \$480 order No. 41

20 Sold 3 Tyres from order No. 40

29 Sold 1 Tyres from order No.41

**Required:**

Prepare a stock card, using standard identification method of stock valuation

## 6.4 SUB- SYSTEM – FIXED ASSETS

### Control over Fixed Assets

**Fixed Assets** – Those that are bought by the business in order to generate revenue.

#### Internal control procedures relating to the purchase of Fixed Assets

##### 1. Authorization

- higher level management must authorize the purchase of fixed assets.

##### 2. Selection

- it is important to know all the facts about the fixed assets before it is purchased.

##### 3. Proof of Ownership

- Purchase should include proof of ownership e.g. title, copyrights and patent documents.
- It is valuable so it should be kept in the safe or bank safety deposits.

##### 4. Payment of cash

- Proper procedures for payments of the purchase should be maintained.

#### Internal control procedures relating to the Disposal of Fixed Assets

##### 1. Authorization

- Higher level authorization should be maintained e.g. management.
- This is to prevent an unauthorized employee selling valuable assets.

##### 2. Physical Disposal

- This could take place in form of outright sale, tender, trade- in or scrapping.
- An authorized person must be in charge of the physical disposal.

##### 3. Receipt of cash

- Proper control should be maintained over receipt of cash.

#### Internal control procedures relating to the Storage of Fixed Assets

##### 1. Location

- All assets should be identified by some means.

- Regular checks should be made to ensure that the fixed assets are situated in their correct place.

## 2. Maintenance

- Assets be kept in good working order.

## 3. Protection

- must be protected against theft or damage.

- Adequate insurance cover should be kept against unforeseen circumstances.

### **Fixed Asset register**

- keeps detailed information about the fixed assets of the business.

### **Purpose of Fixed asset Register**

- + maintains proper control over the fixed assets through the use of control accounts and subsidiary ledgers.
- + To have accurate accounting for fixed assets.

Details kept in the fixed Asset Register	
Name of the asset	Original cost
Depreciation rate	Annual depreciation
Date of purchase	Accumulated depreciation
Supplier	Repairs and maintenance
Estimated life	Method of disposal
Method of depreciation	Proceeds from disposal
Insurance for the asset	

A fixed asset is also categorised as **Property, Plant, and Equipment** in the Statement of financial position of the business.

### **Control over fixed assets**

The internal controls over the acquisition of fixed assets are include the following:

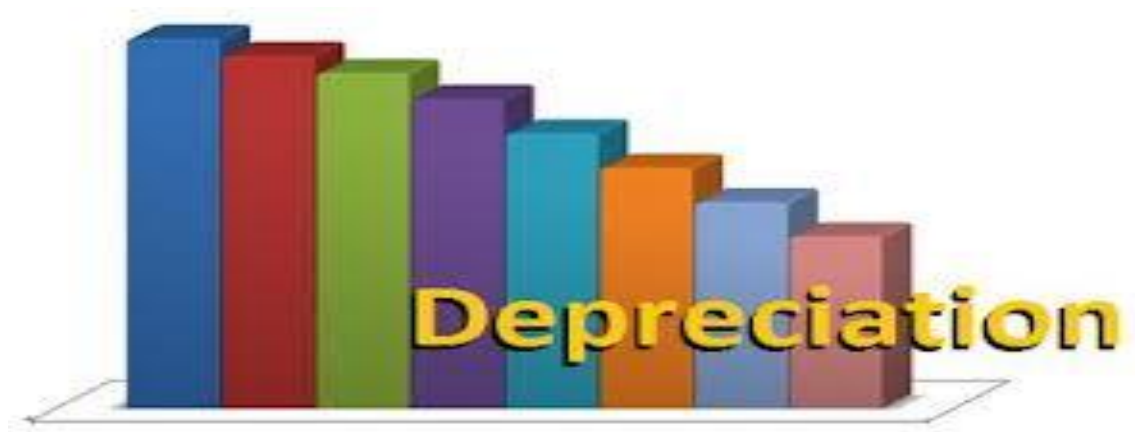
- Issuance and approval of a purchase order.
- Receipt of assets and preparation of a receiving report.
- Receipt of an invoice from a vendor.
- Reconciliation of the vendor invoice to the related receiving report and purchase order.
- Authorization of the payment of the vendor invoice.

- Issuance of a check for payment of the vendor invoice.
- Posting of the entry in the equipment sub ledger.
- Posting of the equipment sub ledger activity to the related general ledger control accounts.
- Reconciliation of the general ledger control accounts to the equipment sub ledger.
- Assignment of reasonable lives for depreciation calculations.



### Activity 6.4.1

1. Define Fixed Assets.
2. Explain **two** procedures that a business needs to follow in order to have good control over purchase and storage of fixed assets.



- ✚ **Depreciation** is a non-cash expense that reduces the value of the fixed asset over time. It refers to the allocating of the original cost of the fixed asset over its useful life.

Business assets that can be depreciated include equipment, machinery, technology and computers, office furniture, buildings and improvements to buildings, leasehold improvements, and business vehicles. Land cannot be depreciated because it appreciates in value.

### **Causes of depreciation**

- **Wear and tear.** For example, an auto will decrease in value because of the mileage, wear on tires, and other factors related to the use of the vehicle.
- **Obsolescence.** Assets also decrease in value as they are replaced by newer models. Last year's car model is less valuable because there is a newer model in the marketplace.
- **Physical Deterioration**  
Value decreases due to flood, excessive heat etc.
- **Passage of time**  
As the time passes the value of fixed assets decreases.

### **Cost Allocation Concept of depreciation on fixed assets**

- ✚ it is important to know depreciation is a cost allocation process.
- ✚ charging of depreciation each year decreases the book value of the asset.
- ✚ the value shown in the balance sheet does not represent the realizable value (market value) the asset could be sold for.
- ✚ it represents the written down cost of the asset.
- ✚ charging of depreciation is a book entry and it does not involve cash.
- ✚ allocating the cost over its useful life does not mean setting cash aside to replace the asset.

### **Factors Affecting Depreciation**

#### **1. *Cost of the asset***

- are all cost incurred to bring the asset into working order with that of the purchase price.

## 2. **Useful life of the asset**

- is the period it is expected to be used in the business.

## 3. **Residual value, scrap value, trade-in value, salvage value, disposal value**

- is the value of the asset at the end of its life .

### **Formulas to Remember on Accounting for Depreciation**

1. Original cost = Purchase price + other cost associated in bringing the asset into location or condition ready for use e.g. Instalment cost

2. Depreciable Cost = Original Cost – Scrap value

3. Accumulated Depreciation = Depreciation of the current year + Sum of depreciation for previous years

**Another name is Provision for depreciation**

4. Book Value = Original Cost – Accumulated Depreciation

5. Rate or % of Depreciation =  $\frac{\text{Depreciation per annum}}{\text{Depreciable Cost}}$

Depreciable Cost

6. Gain on Sale = Difference of (Selling Price > Cost Price)

7. Loss on Sale = Difference of (Selling Price < Cost Price)

### **Methods of Depreciation**

1. **Straight Line Method** – where same amount of depreciation is charged every year.

Advantages	Disadvantages
Easy and convenient to use	May not reflect the true pattern of asset's economic benefits
Suitable for depreciating assets that provide similar level of economic benefits throughout their useful life (e.g. buildings).	

## Formula

$$\begin{aligned} \text{Depreciation per Annum/ Year} &= \frac{\text{Original cost} - \text{Scrap value}}{\text{Estimated useful life}} \\ \text{OR} \\ \text{Depreciation per Annum/ Year} &= \text{Original Cost} \times \text{Rate} \end{aligned}$$

**NB:** Either the formula or rate can be used for calculating depreciation depending on the question.

### Example

On 1 January 2010 a business purchased Equipment for \$6400 cash and installation charges amounted to \$600. Its estimated life was considered to be 5 years with a residual value of \$2000.

### Required:

- ✚ Calculate the Original Cost, Purchase Price or Acquisition cost of the Equipment

Original Cost = Purchase Price + Any other cost

$$\$7000 = \$6400 + \$600$$

- ✚ Calculate the Depreciable Cost of the Equipment

Depreciable Cost = Original Cost – Scrap value

$$\$5000 = \$7000 - \$2000$$

- ✚ Calculate Depreciation per annum for equipment

Depreciation per annum =  $\frac{\text{Original Cost} - \text{Scrap value}}{\text{Estimated Useful Life}}$

$$\begin{aligned} \$1000/ \text{ annum} &= \frac{\$7000 - \$2000}{5 \text{ Years}} \end{aligned}$$

- ✚ Show the calculation in a table

Year	Cost	Depreciation	Accumulated Depreciation	Book Value
2010	\$7000	\$1000	\$1000	<b>\$6000</b>
2011	\$7000	\$1000	\$2000	<b>\$5000</b>
2012	\$7000	\$1000	\$3000	<b>\$4000</b>
2013	\$7000	\$1000	\$4000	<b>\$3000</b>
2014	<b>\$7000</b>	<b>\$1000</b>	<b>\$5000</b>	<b>\$2000</b>

✚ Prepare the General Journal Entry of depreciation for the year 2011

Date	Particulars	Debit \$	Credit \$
31 Dec 2011	Depreciation on Equipment  Provision for depreciation on Equipment ( To record depreciation expense for the year)	1000	1000

✚ Calculate Accumulated Depreciation at the end of the year 2012

$$\begin{aligned}\text{Accumulated Depreciation} &= \$1000 \times 3 \\ &= \$3000\end{aligned}$$

✚ Compute the Book Value of the Equipment at the end of Year 2013

$$\text{Book Value} = \text{Original Cost} - \text{Accumulated Depreciation}$$

$$\mathbf{\$3000} = \$7000 - (\$1000 + \$3000)$$

✚ What would be the **Gain or Loss on sale** if the Equipment was sold for \$6000 at the end of year 2014

$$\text{Gain or Loss on Sale} = \text{Selling Price} - \text{Book Value}$$

$$\mathbf{\$4000} \text{ gain on sale} = \$6000 - (\$7000 - \$5000)$$

Gain on sale because selling price is more than book value



- Show the ledger account for Depreciation on equipment for Years 2010 -2012

Depreciation on Equipment

Year 1 Accumulated Depreciation	\$1000
Year 2 Accumulated Depreciation	\$1000
Year 3 Accumulated Depreciation	\$1000

- Show the ledger account for Provision for Depreciation Year 2010 -2012

Provision for Depreciation

Year 1 Depreciation	\$1000
Year 2 Depreciation	\$2000
Year 3 Depreciation	\$3000

- Show the Balance Sheet (extract) of Equipment at the end of year 2011

Balance Sheet (extract)

<b><u>Fixed Assets</u></b>	
Equipment	\$7000
Less Accumulated depreciation	<u>2000</u>
	<b><u>5000</u></b>



Which accounting idea is reflected by the picture?

Google.com



Activity 6.4.2

- If depreciation is not provided on assets, it will result in one of the following:
  - Funds are not put aside for the asset
  - They will break down more often
  - They will have low residual value
  - Profits are overstated

2. The book value of a building at the end of 2<sup>nd</sup> year for which original cost is \$12000, residual value \$2000 and estimated useful life of 4 years is (use straight line method)

- A. \$10000
- B. \$2500
- C. \$5000
- D. \$7000

3. Jacks Limited, a company acquired a machine on 1<sup>st</sup> January, 2008 for \$67,000. The disposal value of the machine after its estimated usage of 16 years is \$3,000. The company's financial year ends on 31<sup>st</sup> December each year. (Use straight line method)

**Required:**

- i) What is the purpose of providing depreciation on fixed assets?
- ii) Calculate the depreciation for the financial period which ends in 2009.
- iii) What would be the accumulated depreciation for the year which ends in 2010?
- iv) Calculate the gain or loss on sale if the machine is to be sold on 31/12/12 for \$45,000.
- vi) Which accounting concepts are used in writing of depreciation?

**2.**

T. Morris purchased a new truck from John's Motors for \$35000 on 1<sup>st</sup> April 2010. A new body was installed for \$5000 cash to enable the truck to be used for furniture delivery. Insurance and registration of \$500 was also paid by cheque. The estimated life of the truck is four years and the estimated residual value is \$10000. The fixed Installment method of depreciation is used.

**Required**

- a) Show the journal entry to record the purchase of the new truck.
- b) Show the formula to calculate depreciation under Straight line Method.
- c) What is the depreciation per annum?
- d) What is the another name used instead of Straight Line Method.
- e) List down three factors of depreciation.
- f) Calculate the book value of new truck at the end of the third year.

- g) Define the term Depreciation.
- h) Why does the value of fixed assets decrease or depreciate.
- i) What is the purpose of a fixed asset register?

### 3.

Study the ledger accounts given below and answer the questions that follow:

	<u>Office Equipment</u>
July 1 2012 Bank	\$18000

	<u>Provision for Depreciation</u>		
	Dec 31 2012	Depreciation	\$900
	Dec 31 2013	Depreciation	\$1800
	Dec 31 2014	Depreciation	?

#### **Required:**

- a) Calculate the amount of depreciation expense for 2014. The financial year ends on 31 December each year.
- b) Find the percentage rate that is used to calculate depreciation.
- c) Calculate the book value of the office equipment at the end of year 2013.
- d) Show how the office equipment will be recorded in the balance sheet as at 31 December, 2014.
- e) Name one fixed asset that is not depreciated.

#### **Diminishing Value Method**

- The depreciation charge is larger in the early years but decreases as the asset becomes mature.

Advantages	Disadvantages
<ul style="list-style-type: none"> <li>As the asset gets older, repairs and maintenance increases but these cost are offset by lower depreciation in later years</li> </ul>	<ul style="list-style-type: none"> <li>is not appropriate for lease because it does not provide equal amount of depreciation each year</li> </ul>
<ul style="list-style-type: none"> <li>Is appropriate where the risk of obsolescence is high e.g. motor vehicles and machinery</li> </ul>	<ul style="list-style-type: none"> <li>not possible to write the total cost at the end of the life because some balances remain</li> </ul>

## **Units of Production Method**

- Calculates depreciation on the basis of expected output or usage of the fixed asset.
- life is expressed in number of units, mileage, number of hours rather than number of years.
- known as Units of Activity, Units of Usage and Unit of Use method.
- generally used for airplanes, plants, machines.
- depreciation and book value under this method fluctuates depending on the usage in each year.

Advantages	Disadvantages
<ul style="list-style-type: none"> <li>Suitable in case of fixed assets that depreciate in proportion to units of activity rather than just the passage of time.</li> </ul>	<ul style="list-style-type: none"> <li>Is limited to only certain types of assets. Not suitable for furniture or buildings</li> </ul>
<ul style="list-style-type: none"> <li>Most accurately reflects the pattern of consumption of economic benefits.</li> </ul>	<ul style="list-style-type: none"> <li>is solely based on usage, does not take into account assets life.</li> </ul>

**Formula**

**Depreciation per** = **Original Cost – Scrap value**

**Unit** **Estimated Total Production**

**Depreciation per** = **Depreciation per** x **Number of units**  
**Annum** **unit** **in each year**

**OR**

**Depreciation per** = **Original Cost – Scrap value** x **No. of Units p.a**  
**Annum** **Estimated Total Production**

**Example**

Edward purchased a new Toyota Corolla vehicle from Cars Motors Ltd for \$46000. The life of the vehicle is estimated at 300000 kilometers and its residual value at that time will be \$16000. The distance travelled by the Toyota Vehicle was as follows:

<b>Years</b>	<b>Kilometers</b>
<b>1</b>	<b>90000</b>
<b>2</b>	<b>75000</b>
<b>3</b>	<b>80000</b>
<b>4</b>	<b>92000</b>

**Required:**

✚ Calculate the depreciation per kilometer

**Depreciation per** = **Original Cost – Scrap value**

**Unit** **Estimated Total Production**

**\$0.10 per kilometer** = **\$46000 - \$16000**

300000 kilometers

✚ Compute the amount of depreciation for each of the years and complete the table

Year	Original Cost	Working	Annual Depreciation	Accumulated Depreciation	Book Value
1	46000	\$.10/km x 90000	9000	9000	37000
2	46000	\$.10/km x 75000	7500	16500	29500
3	46000	\$.10/km x 80000	8000	24500	21500
4	46000	\$.10/km x 92000	9200	33700	12300

✚ Calculate the profit or loss on sale if the Toyota Vehicle was sold at the end of the second year for \$23000.

Loss on sale = Selling Price – Book Value

**\$6500** = \$23000 - 29500



### Activity 6.4.3

#### Calculations:

1. On January, 2011 Anaseini purchased, Machinery at a cash price of \$70000. She paid \$5000 for landing charges. The Accountant Raju Raj estimated the Machinery would produce 150000 units while the residual value is \$15000.

Actual units produced

Year	Output in units
1	6500
2	8100
3	6200
4	7250

#### Required:

Study the information given above and answer the questions that follow.

a) Calculate depreciation rate per unit

- b) What is the accumulated depreciation at the end of the Third year
  - c) What is the book value of Machinery at the end of First year
  - d) Calculate the gain or loss on sale if the Machine was sold at the end of Second year at \$70000 and prepare the journal entry to record gain or loss on sale
  - e) Prepare the journal entry to record depreciation expense for the Second year
2. Miss Litia purchased a Van worth \$17000 cash. It was estimated that the van would have a useful life of 300000 kilometers and a scrap value of \$2000

The Van traveled as follows:

Year	Kilometers traveled
1	15000
2	22000
3	18000
4	30000

**Required:**

- i) Show the journal entry to record the purchase of the van
- ii) Calculate the depreciation per unit
- iii) Show the journal entry to record the depreciation for the second year
- iv) Calculate the accumulated depreciation at the end of the fourth year
- v) Show the balance sheet extract at the end of the third year
- vi) Show the graph of depreciation expense from Year 1 to Year 4

**➡ Sum of the years' digit method**

Sum of the years' digits depreciation method, like reducing balance method, is a type of accelerated depreciation technique that allocates higher depreciation expense in the earlier years of an asset's useful life.

**Calculate the sum of the years' digits in an asset's useful life**

For an asset having a useful life of 4 years, the sum of the years' digits will be calculated as follows:

**Sum of years' digits = 4 + 3 + 2 + 1 = 10**

Advantages	Disadvantages
✚ Easy to understand and writes off the exact amount of depreciation	Cannot be used for tax purposes
✚ is suitable for use where the services rendered by the asset is larger in the early years depreciation charge is lower in the later years	

### Formula

$$\text{Depreciation} = \frac{(\text{original cost} - \text{Scrap value}) \times \text{NO. of Yrs of life remaining}}{\text{Per Annum} \quad \text{Sum of Digits}}$$

### Example

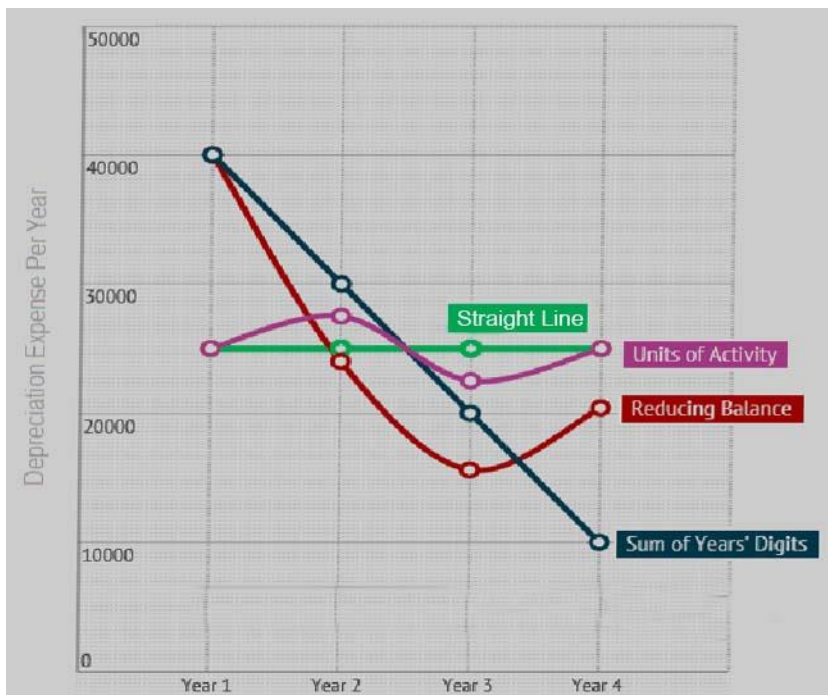
A motor vehicle costing \$10450 was purchased on 1 April 2008 for cash. The estimated useful life of the vehicle is four years and the estimated residual value is \$4000.

a. Calculate the depreciation for each of the 4 years

Year	Years of Digits	Calculation of Depreciation	Annual Depreciation	Accumulated Depreciation
1	4	\$6000 x 4/10	\$2400	2400
2	3	\$6000 x 3/10	\$1800	4200
3	2	\$6000 x 2/10	\$1200	5400
4	1	\$6000 x 1/10	\$600	6000
	10			



**Graph showing the pattern of depreciation for different methods over the years.**



#### Activity 6.4.4

#### Multiple Choice and Calculations

1. A machine which costs \$150,000, had a scrap value of 30,000 was estimated to have a useful economic life of 5 years. Under sum of digit method of depreciation, What is the depreciation for year one.

- A. \$30 000
- B. \$40 000
- C. \$50,000
- D. 12 000

2. Shalini purchased machinery for \$23,000 on 1 April 2011. Installation expenses were \$2,000. The estimated life of the machinery is 5 years and estimated residual value at that time is \$7,000.

#### Required:

- a) Use the sum of digits method to calculate the depreciation for each year.
- b) What is the depreciable cost of the asset?
- c) Show the journal entry to record depreciation for year three.

d) What would be the accumulated depreciation at the end of year five?

e) List down two advantages of sum of digits method.

3. On 1 January 2008, Pacific Line purchased an aeroplane for \$500000. It was expected to have a life of 8000 flying hours spread over four years. Its expected resale value is \$30000.

The flying hours were expected to be:

Year	Hours
2008	2000
2009	1000
2010	3000
2011	2000
	<b>8000</b>





**Required:**

a) Calculate the depreciation for the year ended 31 December, 2008 using the following methods: Show formula and working.

- i) Fixed Installment method
- ii) Units of use method
- iii) Acceleration method

**Revaluation method**

-is used for asset of low value and which are so individual and small. Items on which this method is used are hammers, screw drivers, files, drills, cutlery, table clothes, china and glassware

Advantages	Disadvantages
 helps in providing depreciation for small items of low value	 cannot be used for high value items such as building, vehicles
 is used where it is difficult to estimate the economic life of the asset and residual value	 depreciation is only calculated when the items are lost or damaged even though it may be used year by year in generating revenue

### Example

Ravi is a mechanic and kept the following information about his tools.

The value of tools at the beginning of the year amounted to \$600.

Tools bought during the year were \$200.

Value of tools remaining at the end of the year amounted to \$500.

### Required

Calculate the depreciation on tools

### Formula

$$\text{Depreciation} = \text{Cost of the item at the Beginning of the year} + \text{Purchases made during the year} - \text{Cost of the assets at the end of the Yr}$$

$$\text{\$300} = \text{\$600} + \text{\$200} - \text{\$500}$$



### Activity 6.4.5

1. The most appropriate method used to calculate depreciation for small or loose assets is
  - A. Sum of digit method
  - B. Straight line method
  - C. Unit of use method
  - D. Revaluation method
2. On 1<sup>st</sup> January a restaurant had in its books the following assets

China	\$400
Glassware	<u>700</u>
	\$1100

Purchases of cutlery set \$300.

A revaluation of china and glassware on 31<sup>st</sup> December gives their value as \$1200

Calculate the amount of depreciation

## **Disposal of Fixed Assets**

Fixed assets may be sold anytime during their useful life. This gives rise to the need to derecognize the asset from balance sheet and recognize any resulting gain or loss in the income statement.

The accounting for disposal of fixed assets can be summarized as follows:

- Record cash receive or the receivable created from the sale:
  - Debit
  - Cash/Receivable
- Remove the asset from the balance sheet
  - Debit Sale of Assets A/c
  - Fixed Asset (Net Book Value)
- Recognize the resulting gain or loss
  - Debit Sale of Assets A/c
  - Gain or Loss (Income Statement)

### **Example**

ABC LTD purchased a machine for \$2000 on 1st January 2013 which had a useful life of 5 years and an estimated residual value of \$500. The machine was being depreciated on straight line basis. However, ABC LTD decided to sell the asset on 1 January 2015 for \$1500 in order to raise cash for the purchase of a new machine.

The accounting entries will appear in the ABC LTD's ledger accounts as follows:

<b>Machine Account</b>					
<b>Debit</b>		<b>\$</b>	<b>Credit</b>		<b>\$</b>
<b>2013</b>	Cash	2000	2015	Sale of machine	2000
<b>Accumulated Depreciation</b>					
<b>Debit</b>		<b>\$</b>	<b>Credit</b>		<b>\$</b>
<b>2014</b>	Sale of Machine	600	2013	Depreciation	300
			2014	Depreciation	300
		600			600
<b>Cash Book</b>					
<b>Debit</b>		<b>\$</b>	<b>Credit</b>		<b>\$</b>
<b>2015</b>	Sale of Machine	1500	-	-	-
<b>Sale of Machine Account</b>					
<b>Debit</b>		<b>\$</b>	<b>Credit</b>		<b>\$</b>
<b>2013</b>	Machine cost	2000	2015	Cash	1500
	Gain on sale	100		Accumulated Depreciation	600
		2100			2100

**The gain or loss on disposal is transferred to the Statement of Financial Performance.**

### **Format of Fixed Asset Disposal Account**

<u>Sale/Disposal of Asset A/c</u>			
Fixed Asset (cost price)	xx	Provision for Depreciation	xx
Closing balance (profit on sale)	xx	Fixed Asset (Selling Price)	xx
	<u>xx</u>	Closing balance (loss on sale)	<u>xx</u>



#### **Activity 6.4.6**

1. Zee Ltd purchased a Vehicle for \$25000 on 1st January 2010 which had a useful life of 4 years and an estimated residual value of \$2000. The Vehicle was being depreciated on straight line basis. On 30<sup>th</sup> June 2012 the vehicle was sold for \$6000 in order to raise cash for the purchase of a new vehicle.

a. Prepare the Journal entries to record the accumulated depreciation for the vehicle.

b. Prepare the following ledger accounts:

- Vehicle
- Accumulated Depreciation
- Depreciation
- Sale of Vehicle
- Loss/Gain on sale



## References:

1. Fiji School Leaving Accounting Book 1 & 2 by E Patel
2. Form 5 Accounting Revision (NZSE) by Shirley R Field (NZ Ed)
3. Form 6 Accounting Revision (NZUE) by Robyn Spurdle (NZ Ed)
4. Contemporary Accounting Book One By Richard Prevett
5. Accounting 5 by A. Shariff & Ahmed Shariff.
6. Accounting 6 by A. Shariff & Ahmed Shariff.
7. Standardised Notes on analysis and interpretation of financial statements by CDU.
8. FSLC Revision Workbook by Abdul Shariff.
9. FinED Fiji: A Manual of Teachers Resources By Young Enterprise Trust.
10. Fiji Revenue and Customs Authority website: [www.frca.org.fj](http://www.frca.org.fj)
11. Fiji Institute of Accountants website: [fia@org.fj](http://fia@org.fj)
12. <http://www.businessdictionary.com/definition/doubletaxation.html#ixzz3RHmYePdW>
13. [www.google.com](http://www.google.com)

